OUT IN FRONT

THE INSIDER'S GUIDE TO M&A TRENDS

Navigating Today's M&A Market

SS&C

INTRALINKS

THE M&A ADVISOR

TASK FORCE REPORT

Volume 3

Contents

Introduction

Out IN Front: The Insider's Guide to M&A Trends is a dynamic, peer-generated content hub providing mergers and acquisitions (M&A), restructuring, and corporate finance professionals with an exclusive opportunity to engage with other industry leaders and share their insight on future challenges and opportunities.

An innovative, collaborative approach between The M&A Advisor and Intralinks, an SS&C company, Out IN Front provides timely insight and analysis on topics selected by and delivered to high-level professionals in the M&A arena, capturing their perspectives through a series of outbound surveys. Results are then discussed at quarterly task force meetings and shared through reports.

At the close of the second quarter of 2019, The M&A Advisor, in conjunction with Intralinks, convened a panel of Out IN Front task force members to discuss the results of several Out IN Front surveys as well as other subjects relevant to the industry. The participants, led by David Fergusson, discussed the following topics:

- The Current State of the M&A Market
  - Deal Volume & Deal Value
  - Increasing Valuation Multiples and Availability of Private Equity
  - Cross-Border Investment and China
- Disruption Due to Technology
- The Role of Data and Analytics in M&A

It's a valuable exercise, as we begin to navigate our way through the second half of 2019, to reflect on last year's predictions for the M&A industry; to discuss what's happened year-to-date; and to examine the outlook going forward from the perspective of those who are practicing day-to-day. When members of the Out IN Front task force met at The M&A Advisor's Summit in November 2018, the practitioners agreed that the outlook for the M&A, restructuring, and financing industries for 2019 was mixed. In this report we'll examine how this year has shaped up and what's on the horizon, with the expert opinions of our task force members and the survey respondents.

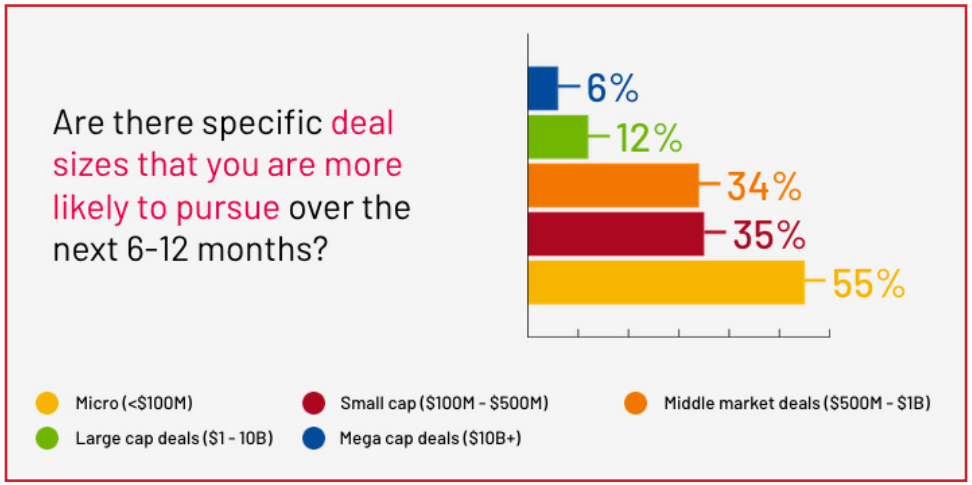
It is our intention, through the Out IN Front series, to spur conversation among M&A practitioners and to open a meaningful dialogue in our industry. To this end, we encourage you to share and discuss this report with your colleagues and, of course, we look forward to hearing your thoughts.

Current State of the M&A Market

Deal Volume & Deal Value

After the economic crash of 2008, everyone became an expert about what happened and why, shared Jack Butler, CEO of Birch Lake Holdings. "The reality is that you generally don't see it until it's there." So, what is Butler seeing now?

Although business is generally good in the merchant bank arena where his company works in advisory, funding, and acquisitions, Butler believes there are storm clouds on the horizon. "While this bull market is off and running pretty hard… the market, in my view, continues to be robust and that has to do largely with the changes in the Fed policy."



Out IN Front Industry Poll #4 - November 2018

Ceasar Anquillare, co-founder, chairman, and CEO of Winchester Capital, a renowned cross-border M&A deal maker between the United States and across the turbulent waters of the Atlantic in the United Kingdom, shared that there was over $800 billion in M&A activity in the first quarter of 2019. "Looking at the numbers and the figures, what has increased, believe it or not, is the value because of the mega deals. What has decreased, by 30 percent, is the number of transactions, which is down to about 3,500 transactions."

"We are struggling in a tide of uncertainty and I think the impact of that uncertainty—China, regulatory uncertainties in the UK and, obviously, in Europe where Brexit has had the most profound impact—is certainly creating unprecedented levels of volatility in our profession," stated Anquillare.

Brexit, the 2016 decision by the UK to withdraw from the European Union, has been referred to as "the long stall" with no decision yet as to whether there will be a deal made between Britain and the EU to soften the exit and bolster the British pound. With

> *The silver lining in the cloud of uncertainty is the certainty that has come into the U.S. market. Foreign direct investment is actually up, and deal value is up. In fact, in the first quarter [of 2019], the U.S. was one of the only places in the world where value was up."*
>
> *- Ceasar Anquillare*
> *Winchester Capital*

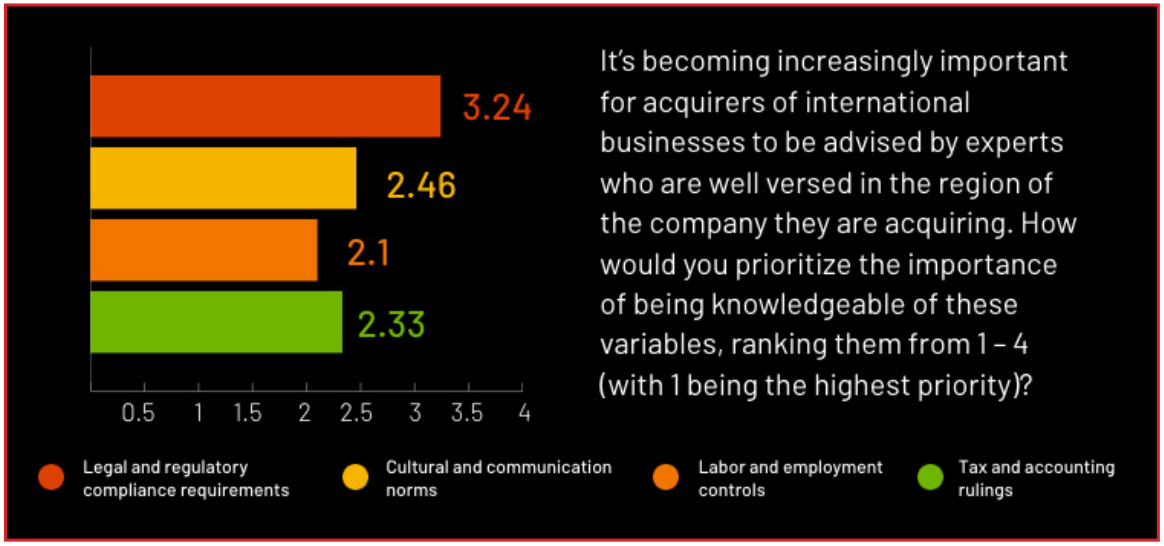
Jack Butler
Birch Lake Holdings

foreign direct investment (FDI) in the UK declining due to the Brexit debate, "How are you planning for that?" asked David Fergusson, chairman of The M&A Advisor.

"I don't think FDI has stabilized, because many of the large companies are really awaiting the outcome of Brexit," said Anquillare. However, he is encouraged by the camaraderie between UK companies—a benefit of Brexit—which hasn't been seen in a long time. Unfortunately, said Anquillare, "the result of that is that the average deal size is coming down."

Trade tariffs and regulations are issues Ian Fay, co-founder and group head of Vier Energy Capital, has also had to deal with in the energy sector. But he's excited about recent developments. "There's been an enormous rush to money and infrastructure build in the Permian [Basin]," shared Fay.

Located in the Southwestern region of the U.S., the Permian Basin is considered the world's top producing onshore oil and natural gas geologic basin. After the oil price recession in 2008, a lot of the private equity money on the investments buy side continued to raise money through the downturn. As a result, Fay explained, there was a big push in the LP community of these big funds to invest. (LP or Limited Partnership, refers to partners in venture capital funds who have limited legal rights and obligations.) There was an enormous amount of cash channeled into the Permian Basin and an enormous land grab ahead of the infrastructure. This created volatility in the U.S. domestic investment community deal flow in the energy space. It dramatically increased the size of the players, with the majors and super-majors doing mini-consolidations just in that one area.



Out IN Front Industry Poll #6 - February 2019

"

How do we distill a thousand opportunities into the two or three deals we're going to execute on in a twelve-month cycle without either failing completely, not doing anything but wasting time, or making a bad decision? A lot of these technologies are about process and efficiency. They're out there and there's a new one coming every day"

- Ian Fay, Vier Energy Capital

Ceasar Anquillare
Winchester Capital

Fay added, "The small players are being gobbled up or, after having reallocated all of their energies to one basin—which is dangerous in any case—are now having to re-strategize how they're going to deploy their capital elsewhere."

Through his boutique advisory firms, Fay has been operating as a kind of merchant banker since 2009, investing in these smaller companies relatively early. "No exploration, but early growth, with a view that there will be multiple asset and monetization opportunities in the future. It's been interesting times. It's exciting because a lot of the bigger dynamics are being played out in a small part of the market." Fay agreed with Butler and Anquillare: "…volume, the number of deals, has gone down. But, the numbers [with respect to deal value] are big so—at least domestically, in the energy patch—what's happened in the United States has been pretty phenomenal."

Like Fay, Terry Mackin, senior managing director, mergers & acquisitions, with Generational Equity, also operates in the lower middle market, but sees the world a bit differently. His firm is expected to do as many, if not more deals than it did in 2018. Mackin believes Generational Equity's agnostic approach enables it to move from industry to industry. Currently, Mackin shared, Generational Equity is working with clients in the steel industry dealing with tariff challenges and simultaneously working with technology service clients whose business is booming. As for those storm clouds out there, Mackin believes Generational's strategy will give it a more recession-resistant roster of clients.

As task force members shared their professional experience and anecdotes, Brian Hwang, director of strategic business & corporate development at Intralinks, brought a unique perspective to the table. Garnered from the *SS&C Intralinks Deal Flow Predictor*—a quarterly publication that predicts M&A deal activity for the upcoming six months based on early-stage, pre-announcement M&A transactions and activity globally—the forecast for North America is for a 2 percent increase in deal volumes from last year.

"We're probably seeing global volume of about 1,300 deals to come across our desk; about 20 percent would be public company targets, and the remainder are middle market and private company targets," Hwang explained. EMEA (Europe, Middle East, and Africa) has seen the most dramatic downturn, said Hwang, with a negative 8 percent in terms of year-over-year comparison, with the caveat that this is compared to three really healthy years of volume.

With deal volume down from last year, Out IN Front task force members talked about deal value and the opportunity for clients to choose their best deals. A value buyer, Jack Butler looks for "very high potential, undervalued companies that have complexity around them…because I don't want to be in an option. I want to be on a proprietary path if I can find it, or on a path with the fewest number of other folks." Complexity, he explained further, does not mean distressed companies but rather represents companies stressed with complications that may scare other players away because, in an upmarket, most buyers have a lower tolerance for challenges.

"

We don't see any real strong abatement through the rest of 2019. The one volatility going into 2020 that I'm sure every deal maker has on their mind is the election. . . and what's going to happen with this administration. That's obviously going to have a big impact on the regulatory side, and on the legislative and judicial sides as well."

- Brian Hwang, Intralinks

Terry Mackin
Generational Equity

"So the anomaly that people don't really focus on is that in an up-market, in a bull market like we're in," Butler said, "Value buyers actually have greater pipelines, better activity, more access to capital than they might have in a down market. In 2008, the gap between what a buyer was willing to buy for and what a seller was wanting to sell for was this big," Butler said, "so no deals got done."

Butler insisted, "Value buyers have a bigger pool of deals to work on."

In response, Terry Mackin added, "In our world, value has always been defined as a company that you can buy for a lower price than the market might bear. Your definition of value though," he said to Butler, "is important to guys like me, because I'm looking at providing as many different options as I can for my client. And, your way of looking at the market, may be that sort of option that's different from what Ian Fay might have."

"It's unfortunate when the deal simply comes down to price," said Mackin. Because the options—the unique features of a particular company or deal—can sometimes make one choice more valuable than the others. "Luckily," Mackin added, "Eighty percent of the clients I have ever sold were not sold for the most amount of money." Like Birch Lake Holdings, Generational Equity follows a value model that looks at how the company being acquired can augment what their clients are trying to accomplish.

This value-proposition model works on the sell side as well, where understanding the benefits to the buyer—beyond a low price—creates a tangible value.

"I think the market is still skewed on the seller side," said Chris Nuttall, managing partner with Lair Partners LLC. He believes we'll start to transition in the next six to twelve months to a buyer's market. "But the market, generally, is pretty benign right now. Financing is still pretty cheap, interest rates are low, and lastly, geopolitical and trade tensions are at their highest, but I think this market still has some way to go before it will be rebalanced in favor of the buyers."

Buyers have a myriad of choices for what to buy. They are starting to be more careful about how they prioritize and choose. Some of these buyers are focused on value, as his colleagues mentioned, but Nuttall is seeing clients looking to buy for strategic reasons as well. "That's a positive trend in the industry, because, at the end of the day, M&A is sustainable when it's done for strategic and financial reasons, not just for financial reasons."

Building on Jack Butler's comment, Nuttall agreed, "When we were contemplating the year ahead [before the start of 2019], we said storm clouds were approaching then. And, I think the storm is still over the horizon. . . buyers are looking at the market even more carefully than they have in the past, because, I think of the elements of valuations."

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You've got to pull in the CRO and sales team early to help. Because you could look at the numbers strategically and extrapolate five-year projections, and it looks like it's going to be a path to profitability. . . [unless] sales can't execute on it."

- Brian Hwang, Intralinks

Chris Nuttall
Lair Partners LLC

Increasing Valuation Multiples and Availability of Private Equity

As predictions go, Out IN Front task force members agreed that the high valuation multiples were a potential warning sign—the proverbial storm brewing on the horizon. "The multiples that people are paying in auctions don't make any sense to me, personally," said Butler. "And, that's not a market we play in or want to." The trade policy, cross-border issues, and inflated multiples are all problematic today, Butler warned.

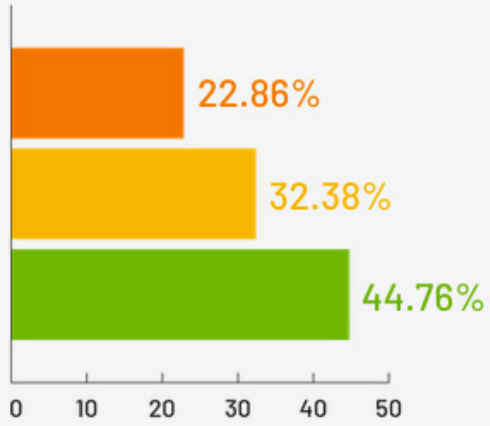
"Looking at where multiples are going, in those industries where multiples are often based on revenue as opposed to evened out, one of the trends we're seeing in 2019 is that certain buyers are beginning to look at the profitability stream," Butler warned. "Buyers are becoming savvier and are no longer willing to pay top dollar for a branded company for 8x multiple without understanding and getting comfortable with an evened-out margin. The days that sellers could simply drive top line, ignore profitability, and assume that such an approach would translate into an early exit, are over. It's more challenging now than it was three years ago," Butler added.

Corey Massella, partner and managing director of UHY, pointed out, "We're all seeing the high multiples on the valuations, and the craziness of what that means." But, Massella believes, "it is mitigated, most of the time, with a very high equity component to their purchasing."

With the increased availability of private equity funds in the marketplace, Nuttall, pointed out that many organizations now have the capital to spend. "Buyers are becoming increasingly strategic about what deals they want to do, especially at such elevated valuations. This is forcing the buyers to really think about prioritizing the range of targets that they have available to them and thinking carefully about what is not just the financial fit—from the value play, from a buy-side perspective—but also the strategic fit."

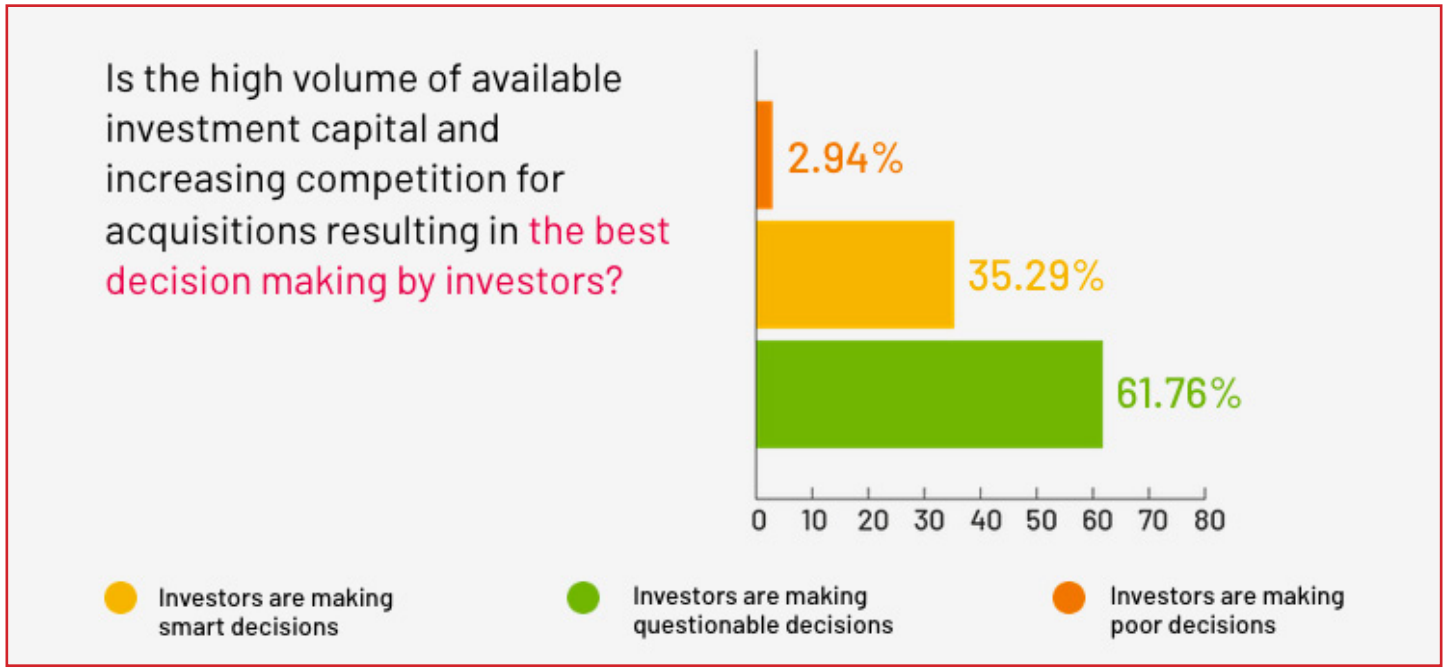
Well-educated and well-funded buyers are not only looking at the intrinsic value of a target acquisition company—what the company is worth on the open market today—but also weighing the strategic value to their organization and in the marketplace. And, while these two elements may drive the valuation multiples up, if a buyer has a particular need for the target acquisition, and, as Mackin pointed out, "they have somebody on their bench that can come in and can run it. . . an executive who understands the industry," that option now resonates with that particular business owner, increasing the combined intrinsic and strategic value.

Valuation multiples are continuing to multiply in this extended seller's market. Can you see a downward adjustment in 2019 or do you think that value growth will continue on its current course?



Valuations will continue to rise · Valuations have plateaued · Valuations will decrease

Out IN Front Industry Poll #5 - December 2018



Out IN Front Industry Poll #5 - December 2018

New funding sources are flooding the U.S. market, including FDI, a foreign entity's purchase of controlling interest in a company outside of their own country. David Fergusson asked Ceasar Anquillare what impact he thought FDI in the U.S. might have on deal volume, deal value, and deal multiples.

"Foreign direct investment is up, along with deal value," noted Anquillare. "It's up to $361 billion this quarter. I think the blessing, or the silver lining in the cloud of uncertainty, is the certainty that has come into the U.S. market." Anquillare further posited that foreign direct investment in the U.S. will continue to grow as foreign companies seek more security.

And FDI works both ways. . .With the decrease in the corporate tax rate, Anquillare noted that U.S. companies are now armed with more treasury capital to be able to go out and make acquisitions abroad. "As the U.S. strengthens, we will be able to make more inexpensive acquisitions abroad and create further value," he added.

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M&A has become a more viable strategy because of the nature of many markets today, the shorter cycle times, and the increasing need for urgency. M&A allows you to save yourself the effort and the cost of building it internally."

- Chris Nuttall
Lair Partners LLC

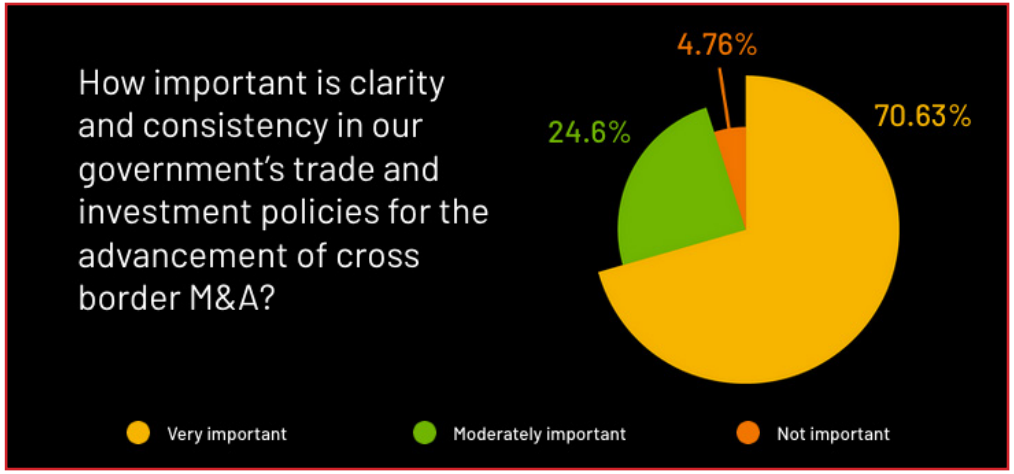
Brian Hwang
Intralinks

Cross-Border Investment and China

One can hardly discuss FDI without contemplating cross-border deal making and China, with government policy heavily affecting both of those conversations. "There are a number of things that are problematic both in terms of our trade policy, and in terms of cross-border issues, that I think are troubling," said Jack Butler.

"You can look at the policies of the current administration, when it comes to regulation and trade affecting business policy, and look at them objectively and say that the willingness of the administration to take on all of these topics aggressively has been a net positive for the business community, even from an M&A perspective," Butler added.

However, he also acknowledged that the propensity of this administration to "play the short game. . . and not worry about what that means five years from now" has a significant impact on the energy sector, for instance, where people make decisions based on how it will affect the future, five or ten years down the road. Butler



Out IN Front Industry Poll #5 - December 2018

Ian Fay
Vier Energy Capital

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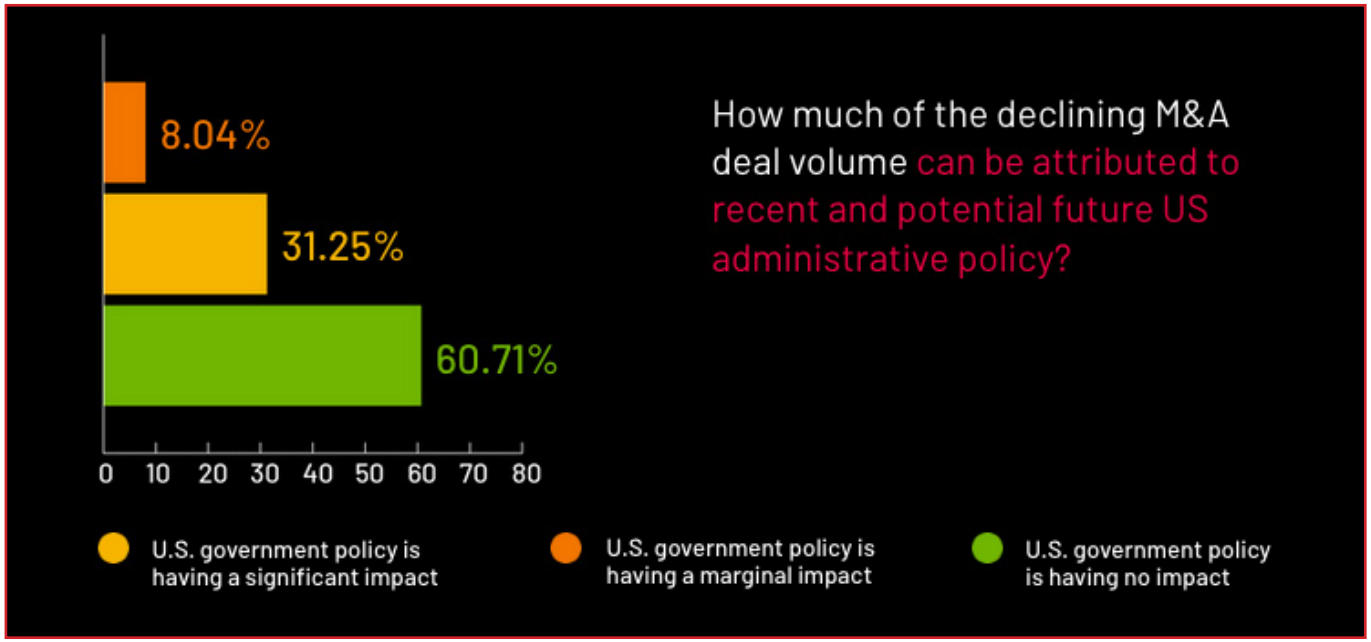
I see 2020 as a very transitional year, potentially, because as markets begin to change and mature, there's the thought out there, 'when is the inevitable downturn going to occur?' And, that has an impact on the overall market."

- Terry Mackin, Generational Equity



Out IN Front Industry Poll #5 – December 2018

acknowledged, "That's part of what that industry is all about!"

"We talk about storm clouds. . ." he continued, "I don't think any of us have a really good understanding of what this is going to mean—what's going on right now in trade, what's going on right now in Europe—to the business community five years from now."

Interestingly, Ian Fay shared that he and his colleagues on the buy side get together to debate the impact of government policy on the energy industry. "For guys that like deep value and distress, who are more comfortable there, can you correlate volatility with alpha generation? That's the holy grail. And, I think that I would rather take volatility because it generates a lot of discussion, and maybe defensive maneuvering and so what that ultimately results in is inefficiency. If you can take advantage of that, then, ultimately, value/alpha will be generated," he added.

Fergusson prodded his fellow task force members, "So do you think it's a meaningful trade off that we're experiencing? Do you think it's actually encouraging investment? What weight would you put on our administration's activities versus other geopolitical

"I think 2019 will defy the middling expectations that were put in place for it last year. . . the geopolitical concerns that people had and the interest rate hikes people expected to occur are not going to happen now, and with the moderated Fed policy, I think the amount of direct investment inflow into the U.S. is going to continue to make this a very robust M&A year. That said, I think there are storm clouds on the horizon that are going to continue to get closer."

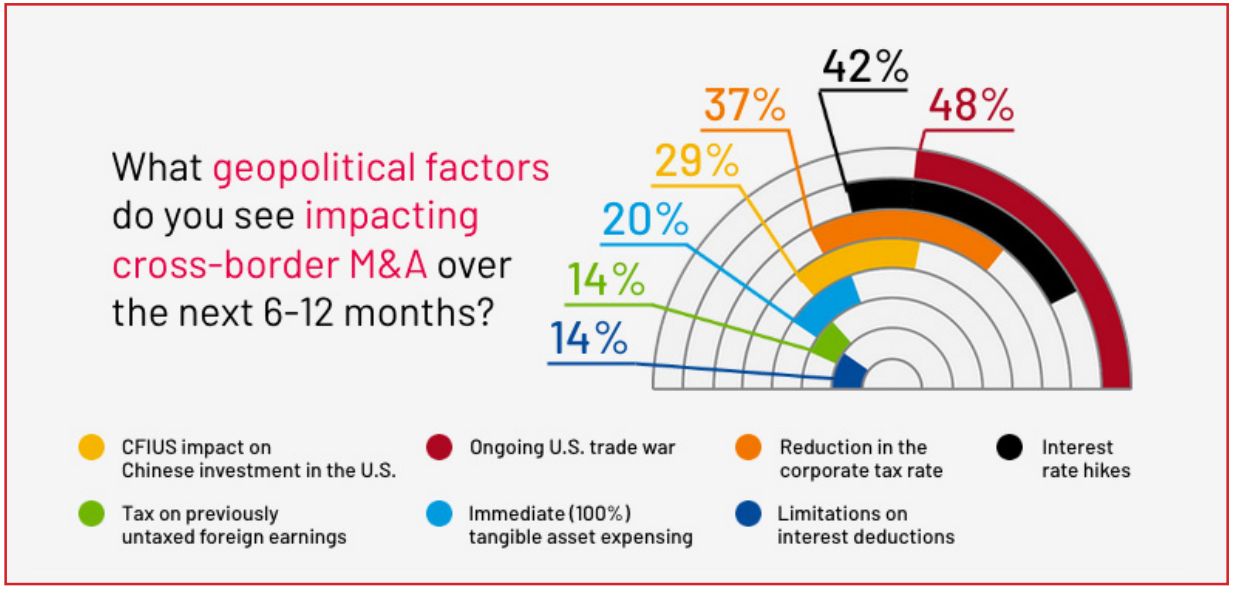
- Jack Butler
Birch Lake Holdings

forces in other countries that perhaps are just making the U.S. look more attractive than it has in the past?"

"It started before this administration," Ceasar Anquillare suggested, "suddenly, this year CFIUS (the Committee on Foreign Investment in the U.S.) has 140 cases in front of it and has actually caused a surge in foreign direct investment. Because people who are in the process of negotiations or doing things that are on that technology border are saying 'let's just get the deal done before it gets hung up in regulatory private market.'"

Anquillare continued, "The flip side of that is that as the value of currencies begins to rise, you have higher waves in the market. You have companies like BP that made an $11 billion acquisition in 2018 in their share line positioning which it might not have done if the market indices were more powerful."

A recent Out IN Front survey noted that, at midyear, after fifteen years of growth, Chinese inbound investment to the U.S. had dropped over 90 percent, and 47 percent believed that cross-border deals were more time-consuming. Despite these disconcerting numbers, and the belief that cross-border deals are more time-consuming, 48 percent of M&A professionals surveyed were expecting to advise more cross-border acquisitions in 2019.



Out IN Front Industry Poll #4 – November 2018

"

There are huge deals. . . and the differentiator is going to be strategy, initiation, execution, because most of the larger players at this point, will only deal with M&A Advisors who are also bringing them capital."

- Ceasar Anquillare
Winchester Capital

Disruption Due to Technology

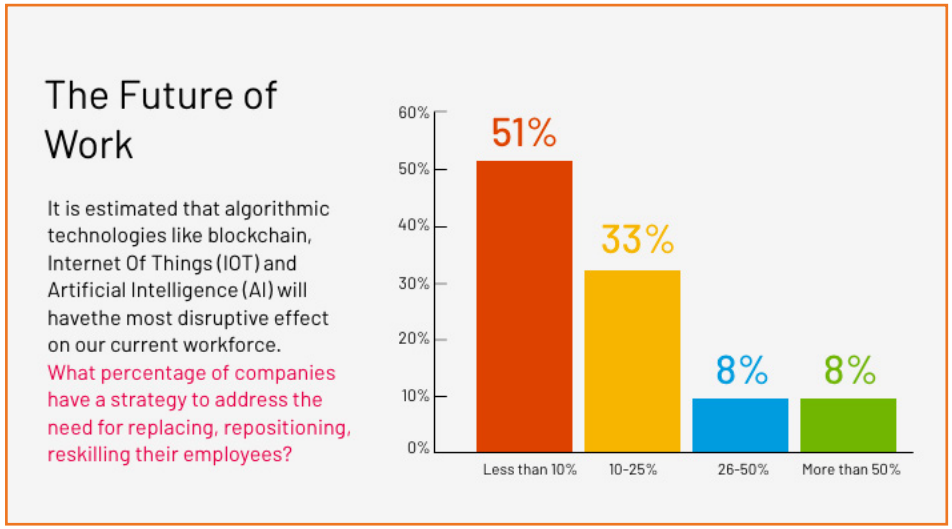
We are in the throes of a technological revolution, an unprecedented era of disruption with technology at its core. In a market overrun with technology options and specialties—digital technology, technology as a service, fintech, legaltech, insurtech, adtech, marketingtech, producttech, there's even M&Atech to help us find deals, and, of course, there's technology for the sake of technology—it is critical for all of us to examine our choices and perform our due diligence.

Terry Mackin said, "We are perceived as a nation of innovators. . . willing to take esoteric leaps of faith in technology because we know how to commercialize everything!"

Having been immersed in the technology scene for the last several years as he undertook research for his recently released book, *The transHuman Code*, David Fergusson said the U.S. might not be at the top of the food chain in terms of technological innovation, but he agreed with Mackin that we are "hands down, the best commercializers in the world today."

According to Ceasar Anquillare, Fergusson was a bit early when he predicted, last year, the rise in partnerships as an alternative to building tech capabilities in-house. "We're seeing that now," said Anquillare who's currently working on a billion-dollar corporate partnership. He added that McKinsey recently did a study showing that over the past five years "more than 50 percent of these corporate partnerships resulted in an M&A deal with advisors."

Chris Nuttall warned, "There is a huge disruption going on in many industries with things like the rise of artificial intelligence (AI) and the Internet of Things (IoT) and various other technologies. . . It's becoming increasingly critical for buyers to really think about the many choices they have, and to be really strategic in what they are investing in, particularly at such elevated valuations." Nuttall believes that technology is partly why the M&A industry is seeing a reduction in deal flow. "Buyers are holding back at such elevated valuations and really waiting and watching, and also contrasting a buy with the build option, which is always an alternative."



Out IN Front Industry Poll #8 – May 2019

Building technology capabilities in-house—organic growth—can be costly, time-consuming, and requires a specific skillset to do it well. Nuttall emphasized his point, "Most technology can be built internally given enough time, effort, and resources, but because of the nature of many markets and cycle times getting shorter, the need for urgency in markets is only increasing."

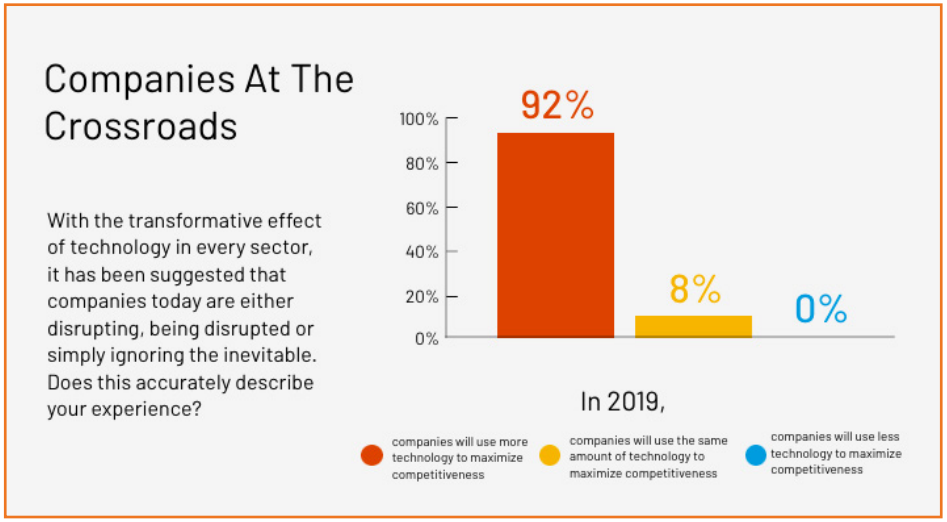
When considering the option value, as Nuttall suggested, you need to ask, "How do we get ahead of the competition? Is it better to acquire the capability or to build it? What's the time to market and how does that fit into the broader strategic intent for our core business?"

Brian Hwang warned, "There are a lot of technology companies that build in a lot of features and build their company around that. This is not a sustainable path forward as a growth company. Still, there are a lot of good pickings out there in the lower middle market. Despite high valuations, there are still companies out there with a pathway to real profitability." "When you find them," Mackin said, "be prepared for the feeding frenzy that follows that may drive multiples up." He added that no one wants to stay in that frenzy for long. Ultimately, the seller chooses a buyer; hopefully one whose motivation includes a strategic fit component.

M&A becomes a viable strategy to get into or expand in a market much more quickly than if you were to build that capability yourself. And so, Nuttall explained, "I'm seeing a lot of organizations that are really actively looking at that build versus buy trade off and saying, 'Hey we could build this IoT capability ourselves.' But it's going to take us six months, a year, two years to do that and by that time the market will have moved on. And we're going to miss out on a big market opportunity."

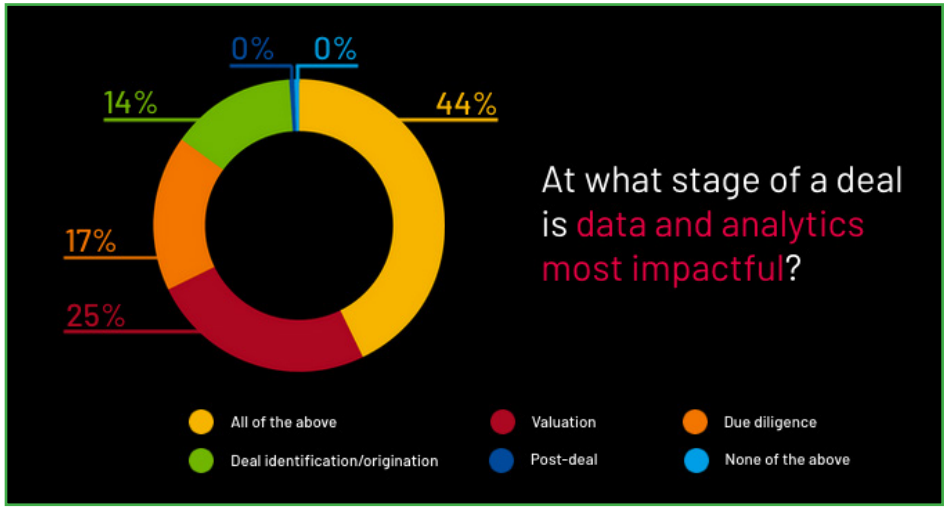
Fay added that it's important that we all remain open-minded about new technologies whether we're looking at tech for our clients or for our own companies. Just as critical, we need to recognize that there are thousands of companies trying to compete in any given area, including with our own companies. "Technology is an enabler. It allows us to see more and do more without falling to the wayside," said Fay.

Merger integration proforma refers to the post-merger work undertaken to physically and operationally join two merged companies together. Fay warned that this is the biggest pitfall in the M&A process. With the increased volume of smaller technologies coupled with greater speed of integration, you're going to see misfires. Fergusson, who expressed similar concerns about what he calls the absorption and commercialization capabilities when integrating technology, said he's been seeing more missteps in the last four months than he has seen in the past two years. "I think more chances are being taken intentionally than perhaps they have in the past. So, it's at the risk of disruption and, perhaps an inkling of desiring to be a disruptor."

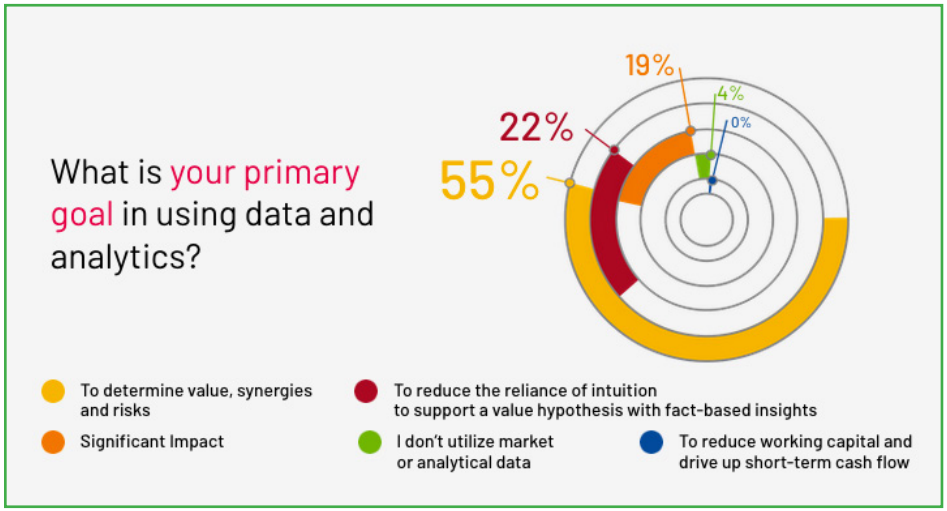


Out IN Front Industry Poll #8 – May 2019

The Role of Data and Analytics in M&A



Out IN Front Industry Poll #4 – November 2018



Out IN Front Industry Poll #4 – November 2018

To some degree, data can help mitigate some of that risk. As Chris Nuttall pointed out, "It's not about the quantity, it's about the quality! The problem is, we live in a big data world and, unfortunately, sellers aren't always as open with their data sets as they could be." While that may limit the data we have access to "it's not about getting more data, it's about getting the right data," said Nuttall.

At the end of the day, as Jack Butler pointed out, "it's all about gathering data and trying to understand it, trying to process it, and getting good information flow so that things come to my dashboard from our pipeline team that are worth spending time on."

Conclusion

Today's challenging political climate and its influence on global trade and business operations, as well as the resulting strained relations with China, have had a significant impact on the cross-border and domestic M&A industry. With deal volume down, deal value up, and increasing capital in the market, our panel of experts agree that the implications, like the outlook for 2019, remain somewhat mixed depending on what type of deals you're involved in and where.

Now more than ever, taking advantage of new technologies, ensuring accurate data, and optimizing partnerships will be the differentiator. Our panel of expert deal makers gathered to share their experience and insight in today's volatile marketplace to help you successfully navigate today's challenging business environment. How will you use these insights to foster growth in your company and industry?

Task Force Members

Ceasar N. Anquillare
Co-founder
Chairman and CEO
Winchester Capital

Jack Butler
CEO
Birch Lake Holdings

Ian Fay
Co-founder & Group Head
Vier Energy Capital

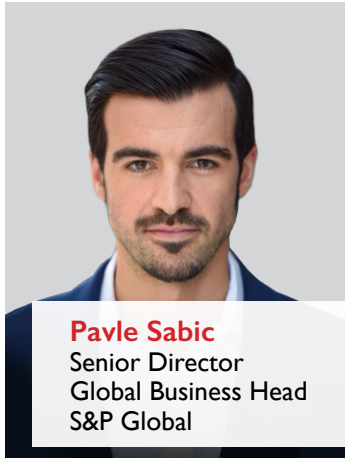
David Fergusson
Chairman
The M&A Advisor

Brian Hwang
Director of Strategic
Business & Corporate Dev.
Intralinks

Terry Mackin
Senior Managing Director
Mergers & Acquisitions
Generational Equity

Corey Massella
Partner
Managing Director
UHY

Chris Nuttall
Managing Partner
Laird Partners LLC



Pavle Sabic
Senior Director
Global Business Head
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SS&C Intralinks

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