

Global Capital Raising In the Current Environment The U.S. Capital Market Perspective

We have all begun to adjust to the “new realities” of the M&A market as it is impacted by the significant shifts in capital availability and capital pricing since mid-2007.

The aggressive market that existed up until July 2007 had resulted in record levels of deal capital flowing into private equity funds and hedge funds, which along with abundant debt financing, combined to fuel a huge volume of M&A transactions. The prevailing market conditions also lead to higher transaction multiples that were well above historical levels, driven by competition among financial and strategic buyers for attractive targets. These same market conditions also resulted in progressively higher leverage multiples, with senior debt exceeding 5.5 times EBITDA and total transactional debt hitting 6.3 times EBITDA and sometimes higher. At the same time, the so-called “size/value” gap had begun to narrow to the point where the difference in multiples paid for larger companies versus middle market companies had become the smallest in recent history.

Since mid-2007, market conditions have changed significantly. Market liquidity has been greatly reduced, as banks faced capacity constraints caused by the heavy downward pressure on their balance sheets from the enormous sub-prime mortgage delinquencies. In addition, there was virtually no new CLO issuance in the market during the summer, thereby denying the public market a major source of liquidity to support other capital-raising transactions. The broad syndicated loan market almost completely shut down at one point, forcing many of the larger transactions to either be postponed or abandoned.

Along with these pressures, borrowing costs increased considerably, causing M&A financings to be reworked to reflect decreased leverage and heavier equity in order to be completed in the more challenging market environment. At the same time, lenders started to re-evaluate the risk-pricing associated with borrowed capital, with LIBOR spreads jumping over 100 basis points over just a few months in the last half of 2007. Transaction structures also tightened with the increased business risk assessment, as protective covenants were ratcheted upward with PIK and so-called “covenant-light” deals becoming very scarce and much more difficult to achieve. This sea change in capital market conditions invariably had a negative impact on M&A activity as deal volume declined approximately 32% and transaction value decreased 48% from the end of 2Q-2007 to the end of 1Q-2008 for U.S. transactions of \$1 billion or less.

Through all of this market “fog”, the current dynamics of the private equity market has begun to reflect a measure of hope for the period ahead. While there is a new emphasis on business fundamentals and free cash flow in M&A deals generally, the market dynamics is still largely influenced by favorable “buy-side” and “sell-side” factors that should continue to sustain a continuing M&A market.

On the “buy-side”, there is continuing pressure by private equity groups and hedge funds to deploy their huge cache of accumulated equity funds. Also, public companies continue to seek to shed many of their non-core operations to slim down for an economic downturn of uncertain duration. In addition, there are numerous private companies with shareholder liquidity and estate-planning issues that need to be

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resolved even in the new market climate. And the banks, while temporarily discombobulated, are beginning to repair their deal capital processes with thought out consortium deals to reduce or at least manage their exposure, while also increasing the range of fundable acquisitions.

On the “sell-side”, the silver lining is that there are still historically attractive valuations available to sellers, although it will still take some time for many sellers to adjust to the recent reduction in available valuations. Adding to the potential supply of M&A deals is the increased aging of many institutional investor portfolios, with companies that have enjoyed extended funding now overdue for an “exit” or a recapitalization through a strategic buyer or a new set of financial investors with fresh equity capital. This should continue to provide positive “supply-side” opportunities for sellers willing to adjust their valuations to realistic levels. In the current competitive environment, there is an advantage for cash-rich under-leveraged companies which are able to use their stock and/or cash resources to capture the most interesting deals.

For the benefit of the many institutional and strategic investors in OEM Capital’s network of technology-oriented investors, we have provided a link to some [statistical slides](#) that illustrate the market conditions which we have highlighted above. Hopefully, these statistical indices will be useful “measuring sticks” for many of you as you follow the current M&A market. Accordingly, we shall endeavor to provide an update of these M&A indices to you on a continuing basis as you plan your strategies as either “buyers” or “sellers” for the remainder of 2008 and beyond.

Let us know if our technology bankers at OEM Capital can assist you and your firm in implementing your acquisition strategies in the months ahead.

We also have a monthly electronic newsletter covering deals in the IT and Technology sector. If you are interested in receiving this (if you don’t receive it already), please send me an email or [register on our web site](#).



Timothy E. Sweet is a Managing Director of OEM Capital Corp. Mr. Sweet has over 30 years of corporate finance experience focused primarily on private placements made on behalf of middle market and larger corporate clients. Prior to joining OEM Capital, Mr. Sweet was a Managing Director with Glocap Advisors LLC, a boutique investment banking firm, where he assisted companies in raising private equity, PIPES and mezzanine capital. Earlier, Mr. Sweet was head of private placements at Stephens, Inc., where he completed over \$850 million in security placements. Before joining Stephens, Mr. Sweet headed the private equity group at Bear Stearns and prior to that was head of Dean Witter's private placement group. He has completed more than \$7.0 billion in financings over that period.

Mr. Sweet graduated from the College of William and Mary and has a Masters of Arts degree in International Relations from Columbia University. He received a Master of Business Administration from Harvard University's Graduate School of Business Administration.

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