Transaction **Trends**

This issue of *Transaction Trends* includes data and commentary on relevant and interesting developments affecting middle-market leveraged finance and private equity in the first quarter of 2016.

Transaction Trends provides private equity sponsors with middle-market transaction information and insights compiled by the BMO Harris Sponsor Finance group—information that helps sponsors better understand the current financing climate in the middle market.

Industry Focus: Multisite Businesses

Multisite business models have common operating strategies across numerous industries, with many found in the healthcare (such as physician practice management, behavioral health facilities and pharmacies) and consumer sectors (including veterinary clinics, athletic clubs, restaurants and franchisors). Both private equity sponsors and lenders are highly interested in multisite investments, given the inherent geographic diversity, high level of recurring revenue and consistent financial performance.

BMO has a strong track record in financing multisite businesses and understands the unique aspects of structuring, documenting and syndicating these types of transactions. Over the last five years, BMO has successfully financed approximately 40 multisite businesses and currently has more than 20 companies in our portfolio. Multisite models are highly leverageable given the attractive credit characteristics of these types of transactions. It is common for established healthcare or food/consumer multisite businesses with a proven track record and established critical mass to obtain senior and total leverage levels of 4.0x/5.5x or higher with a number of pro forma adjustments for new store openings and costs associated with them.

De novo models require upfront due diligence to determine appropriate site selection (including market demographics, competitive landscape, location and buildout) and timing, since new locations generate losses as they ramp to a mature level of volume and profitability. Given the cash outlays and time it takes to get to maturity, sellers expect to get paid on EBITDA for newer units by adding back de novo losses and a maturation adjustment.

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Typically, BMO supports both costs related to opening a new site and the maturation adjustment as EBITDA adjustments. The maturation adjustment is typically limited to a:

- Set period after opening
- Dollar cap per new site
- Maximum percentage of adjusted EBITDA

Maturation credit for "immature" de novo models is given if there is a proven track record of ramping up to a consistent level of EBITDA in a similar time period.

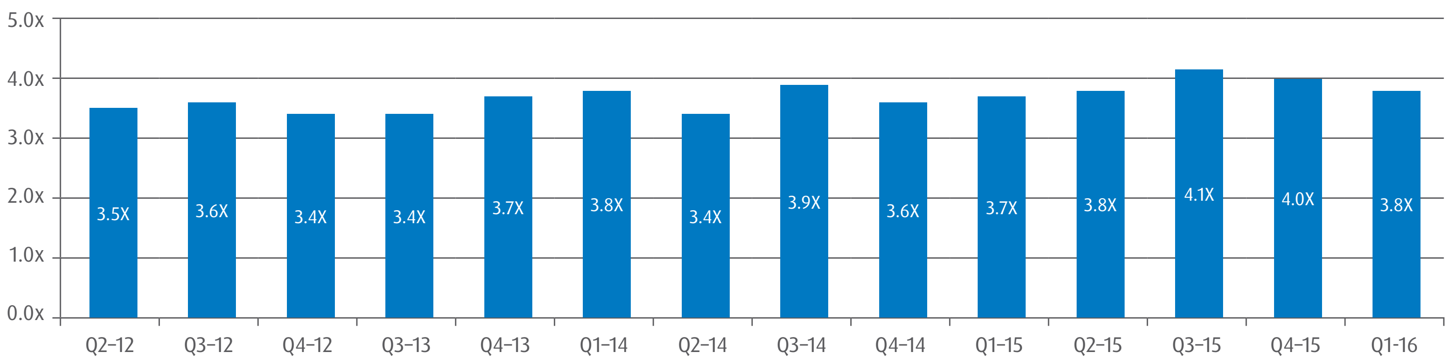
Finally, multisite businesses have significant upfront capital expenditures. Due to the significant cash flow requirement, many of these businesses generate negative free cash flow and utilize revolvers and DDTLs to maximize the de novo buildout strategy.

Featured Multisite Businesses

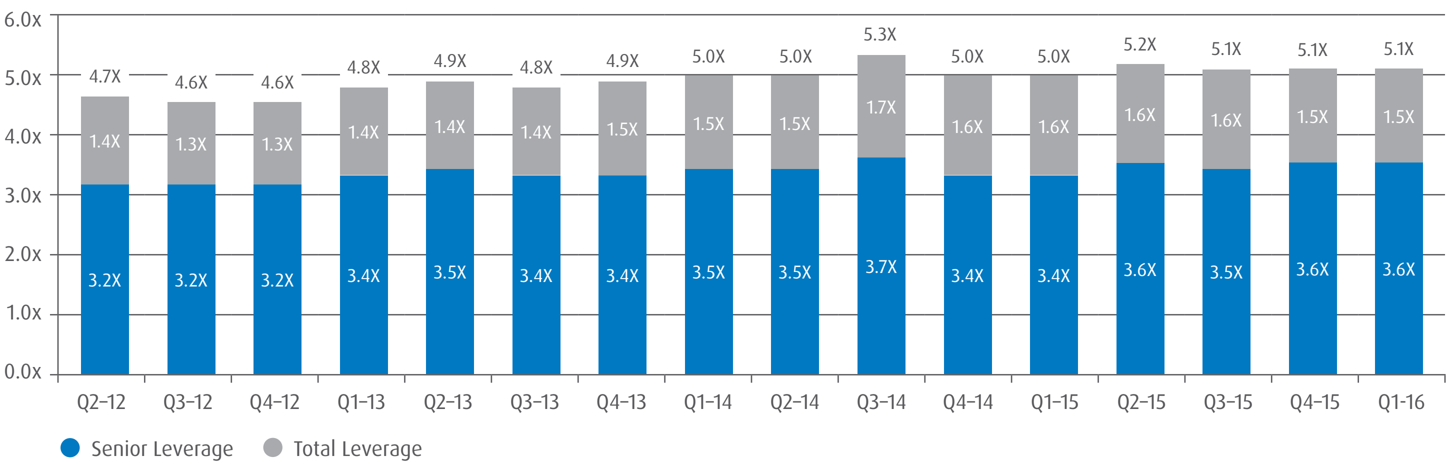
Leverage

While market activity remained sluggish in the first quarter, leverage levels in the middle market remained at historic highs. The charts below show senior-only deals with leverage near the 4x range and leverage in senior/junior structures over 5x due to a bifurcation of the deals in the market. The credit quality of companies in auction have been at opposite ends of the barbell, with the lower quality companies drawing little attention and the higher quality companies creating a frenzy for both buyers and financiers. These high-quality businesses attained leverage levels of 6.0x+ total, with no pressure on minimum equity capitalization due to high purchase prices. At the lower end of credit quality, tougher stories are getting leverage at the lower end of the market—typically in the range of 3x/4.5x. This widening dynamic has created volatile equity stories in addition to challenging debt financings.

All-senior leverage



Senior/total leverage

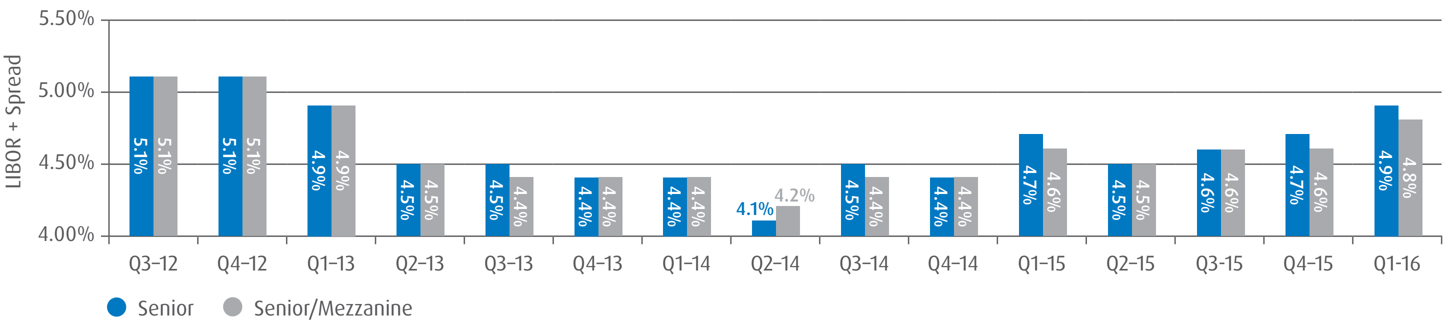


Pricing

With increasing interest rates, concerns about the global economic outlook and general market conditions, the middle market experienced a pronounced jump in prices. For the third quarter in a row, senior debt pricing increased, moving from L+450-475 with a 99 OID, to L+500-550 with a 98-99 OID. LIBOR floors remained consistent at 100 bps. Over the previous nine months, the premium in the large market spread and mid-market pricing has widened significantly to 120 bps. Over the same time frame, CLO issuances have declined due to risk retention requirements and an increase in pricing for CLO liabilities. As a result, many independent finance companies were forced to significantly increase their pricing requirements.

Also, these firms look at the relative value between putting money to work in the large market or continuing to play in the middle market, which is creating the need for additional pricing in middle market deals. Any credit story with some noise to it will get penalized with a pricing premium, creeping up into the L+600 range. Conversely, financings that can be completed with relationship debt providers can get significantly better pricing, even L+450 with a grid for further step-downs.

Pricing—spread over LIBOR

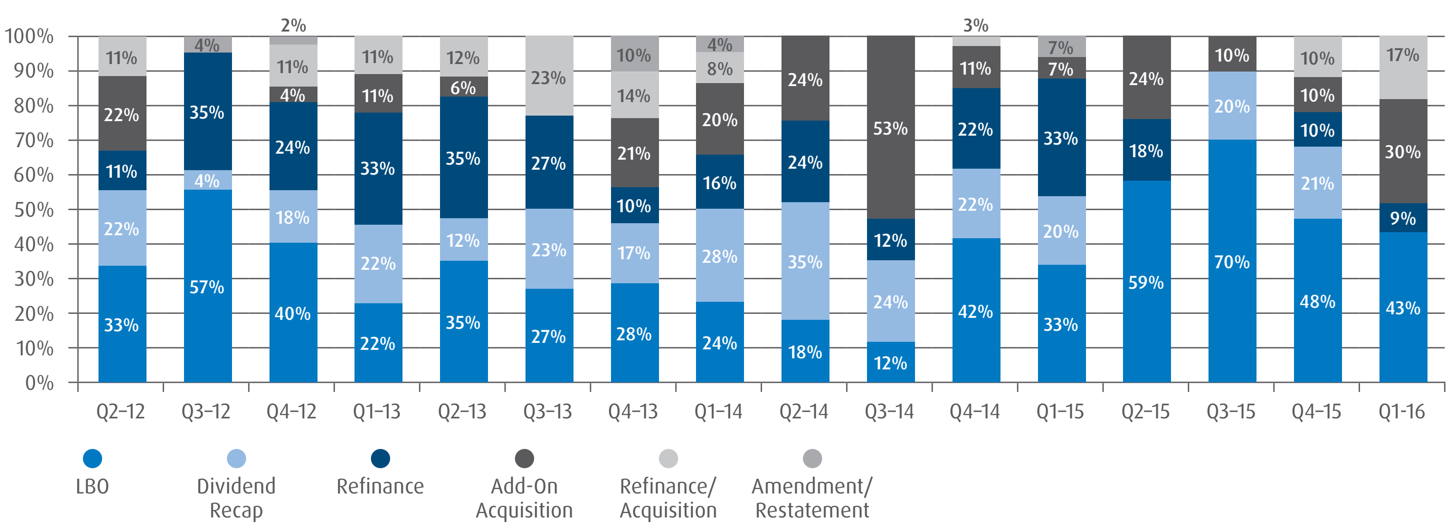


Use of proceeds

The first quarter saw an influx of add-on acquisition activity for our portfolio accounts, creating a need for new or increased senior and subordinated credit facilities. Add-on acquisitions were popular within our industrial sector, representing 50 percent of the activity for the quarter, and the vast majority of the transactions were for companies with $20 million to $40 million of post-acquisition EBITDA. Where possible, sponsors used existing credit agreements and relationship lenders to close add-on acquisitions, rather than opening the credit agreement and repricing the deal to entice new lenders in this pricier environment.

Noticeably absent this quarter in use of proceeds were dividends and recaps. While dividend activity has historically been steady over the last couple of years within BMO's portfolio, sponsors were hesitant to tap the market for dividends given the current pricing environment.

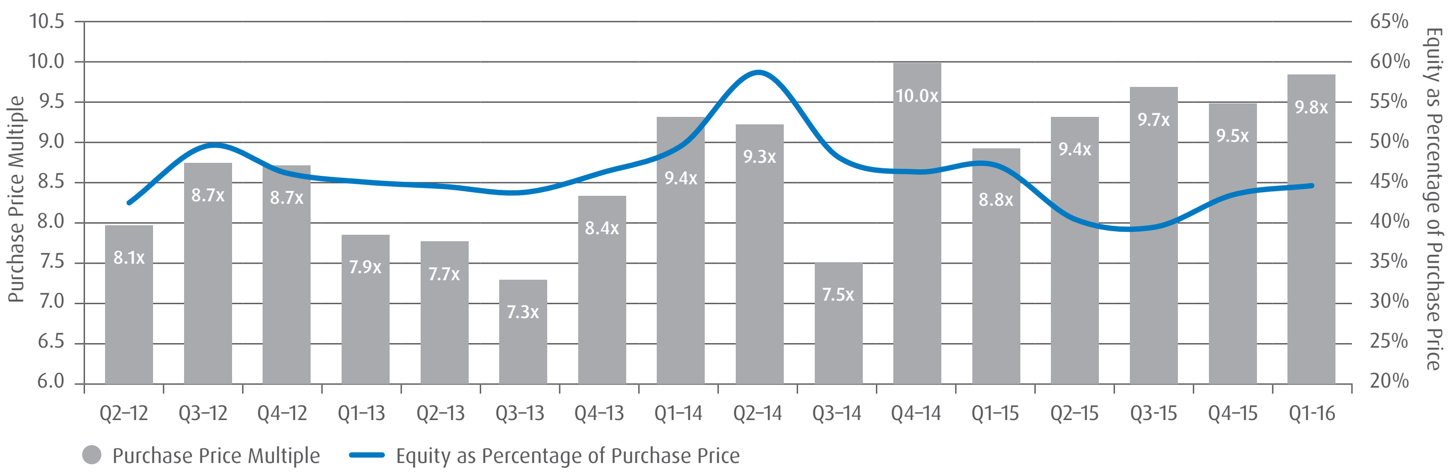
Use of proceeds—closed deals



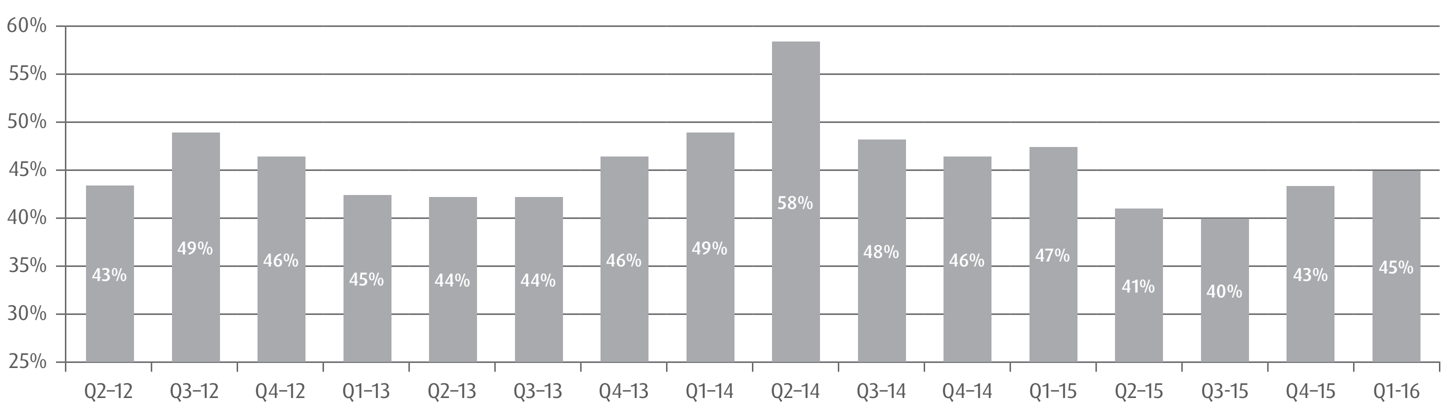
Purchase price multiples/equity as a percentage of purchase price

Purchase price multiples remained at elevated levels as deal flow remained depressed, with the best assets being chased by multiple bidders. We continued to see processes requiring "check-in bids" and for bidders to complete third-party work in advance of exclusivity. In addition, there have been a number of auction processes where seller expectations were driven higher than the value of the business. As a result, the hype around an asset caused would-be bidders to drop out of the process. High enterprise values have kept equity checks at healthy levels, averaging 45 percent of capital structures with the average purchase multiple reaching its second-highest point over the last four years.

Purchase price multiples



Equity as a percentage of purchase price



About us

Consistency, speed and surety of close are crucial when it comes to serving the needs of middle-market private equity firms. Whether it's providing capital for mergers and acquisitions, leveraged buyouts, recapitalizations or growth capital, BMO Harris Bank's Sponsor Finance group works with you from initial review to ongoing portfolio management for reliable execution and follow-through with no handoffs.

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