2017 M&A OUTLOOK: CHANGES AHEAD: WHAT DOES IT MEAN FOR M&A?

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Operator: With that, let's go ahead and begin today's PNC Advisory Series event. It is my pleasure to turn today's call over to our moderator for today, Matt Francati, Associate with Harris Williams and Company. Matt, with that, I'll turn the floor over to you.

Matt Francati: Thanks, Aaron, and good afternoon, everyone, and welcome to our PNC Advisory Series webinar, 2017 M&A Outlook, Changes Ahead — What Do they Mean for M&A? Thank you for joining us.

Before we get started with our presentation, I wanted to highlight PNC's ongoing commitment to providing market insights, new ideas, and best practices like you are about to hear. Our commitment is reflected in the types of conversations our bankers are having with companies like yours every day. It is also reflected in our PNC Ideas thought leadership series, which features a monthly newsletter, live webinars, and a dedicated website at PNC.com/ideas. From brief videos, articles, and economic reports to financial market commentary and webinar replays, we continue to choose topics and formulate our ideas based on the input we get from you. So at the end of today's session, please provide the feedback we need to keep focusing on the right information for you and your company.

Okay, let's get started with our event. We are excited to have Bill Watkins and Larissa Rozycki as our presenters today. They will discuss how 2016 included a number of significant political and economic events which will usher in changes throughout 2017 and what potential impacts this will have on M&A activity. We will facilitate a question-and-answer session at the end of our prepared remarks. You can submit questions any time throughout the presentation using the questions widget found in the lower portion of your screen.

So with all that, let me turn it over to the presenters, and they'll take it from here. And again, thank you for joining us. Bill, I'll hand it over to you to begin.

Bill Watkins: Thanks a lot, Matt, and thanks again for everybody participating today. We look forward to not only delivering our content but also answering as many questions as we can as we wrap up. I don't know if you all see a table of contents in front of you right now, so you kind of get the layout of what we're going to be talking about today. I'm just going to quickly kick things off with a brief overview of Harris Williams and Company for those of you who may not be familiar with our firm, and then we'll kind of get into the meat of the content.

As a firm ourselves, we've been around for 25 years, and our business model has not changed. All we have done from start to finish is provide M&A advisory services, and even more so, microscopic focus around sell-side M&A. Today we have eight offices — six in the U.S. and two in Europe. And we also have partner firms that help us collaborate on cross-border transactions respective to Asia, particularly around India and China.

Over the last three years, we've averaged north of 60 closed sell-side assignments per year and also a variety of buy-side fairness opinions and other valuation assignments, really focused around the M&A product. And in particular in 2016, we closed 64 transactions, and when we look at our backlog today, it is double-digit percentages ahead of where we were at this time in the comparable period in 2016. So as you hear about our perspective on M&A, you're going to hear a pretty robust one as we sit here in February of 2017.

Many of you on the phone today understand that we have a long history with PNC and a connection to the bank. And that connection is today as a wholly-owned subsidiary. PNC acquired our business over 11-plus years ago, so like many of you on the phone today who have been through an M&A transaction, so have we. We know what it's about. We know the ins and outs. We know the emotion that goes through it, and we found a great partner within PNC for the last, again, 11-plus years.

The bank, similar to our business, the bank has done a lot in terms of investment over the past few years in terms of its products, its people, and its infrastructure, particularly in the advisory arena. So in addition to Harris Williams and Company in M&A , the bank also has IPO and equity advisory services, ECM advisory services with Solebury, also has built out an ESOP advisory practice, so we tend to think within the PNC umbrella, start to finish, we have great advice around the liquidity spectrum.

On the next page, like many firms in the middle market, as well as most bracket firms, we have really augmented our M&A advisory experience with industry expertise. You'll see here on the page, these are 10 verticals that all of our bankers, starting from the first-year analysts out of college all the way up through the most senior managing directors, fall within at least one of these industry verticals and again are bringing that content around the M&A advice.

For those of you who are not active, please take a look at our website, www.harriswilliams.com. You'll find all of this content available. Feel free to take as much as you want, because that's what we do it there for, is to continue to educate our clients and prospects and other advisors.

And then the last page of this section is just really illustrative of our velocity and really investment across our business, our offices as well as our industry verticals. You see here a number of different transactions we closed over the past 12 to 15 months. Again, a variety of industry verticals, and we would be remiss and not be considered investment bankers without a (inaudible) page. But with that, I do want to end the brief commercial and really get into the heart of the content.

So I'll turn it over to Larissa now to get into more of a macroeconomic update.

Larissa Rozycki: Thanks, Bill. We thought it made sense to dive into some economic themes and stuff tends to be, and it's seemingly been the broader umbrella around what's driving the M&A market, and certainly, some of the broader economic themes are going to be playing a role in terms of what we view for the M&A market in 2017 and certainly beyond.

So we're going to kind of start big, thinking through kind of the global environment, and then drill down into a lot of the factors that are affecting the U.S. economy. And then, like I said, subsequently the M&A market as a whole.

So looking at slide 10, this really touches on the global economic environment. And it's no secret that global economic growth over the past few years has been tepid at best. GDP since 2012, the growth has really remained below the historical median that we see in that chart on the bottom right. The historical median's about 3.3%, and since 2012, we've been below that threshold.

Current events have really been of little help in terms of easing some of the concerns around the economic growth that we've seen. The first slide on this slide — or the first bullet, excuse me — really touches on a host of events that have contributed to a general sense of macroeconomic uncertainty. That said, prospects for global growth in 2017 are fairly optimistic. Most U.S. business surveys suggest that activity has increased in developed regions, in particular the United States, Europe and Japan. However, some key emerging economies are still seeing slow growth but aren't necessarily yet considered in a recessionary environment.

The chart on the left of this slide really highlights that. It shows estimated growth for 2016, since we're still dealing with preliminary figures, and the forecast for 2017 by geographic region. So you can see that there are several developed regions, including the United States, again, the Euro Zone still seeing some favorable growth in 2017. So we're seeing some positive trends that are going to be there. On an aggregate perspective, we're seeing a positive trend in terms of projected growth activity as a whole in the world, so those orange bars that are in that chart on the left really demonstrate growth over the prior period.

So there's a host of factors which have been highlighted as having potential influence on global GDP going forward — monetary policy, trade agreements, potential repatriation of cash overseas, tax policies, just naming a few. But not much clarity exists at this point around what the implications might be yet. So more to come on that front. But in short, the key takeaway from this slide is that GDP prospects may feel like somewhat of a mixed bag, but there's an overall sense of positive momentum.

So flipping forward to slide 11, I wanted to touch briefly on the U.S. GDP. The U.S. continues to be one of the driving forces for global growth, if not the cornerstone, and prospects domestically remain pretty strong. While varying in magnitude, the U.S. has experienced positive GDP growth for 11 consecutive quarters. So while sometimes it does feel a little bit difficult at times, it is still a positive trend, as has been the case with — since the Great Recession — the private sector really is responsible for driving all domestic GDP growth. Consumer spending as a percentage of GDP, as evidenced by the chart on the bottom right, really has increased steadily since 2013, and net investment has continued to remain a relative constant. Over the next few slides, we'll look at a few of the key drivers of domestic growth to help outline the state of the economy.

So we'd be remiss without addressing a new variable in the broader economy. Under the new presidential administration, it seems likely that the U.S. is going to announce a fiscal stimulus, which is going to reinforce the trend for stronger growth in the United States. So this is expected in the next few months, though uncertainty around the nature of the stimulus — what it might contain, the magnitude of the dollar figure we're talking about, as well as the receptivity among Congress — is still going to be something to be determined.

So flipping to slide 12 and looking at business investment, obviously something that everybody on the phone is going to be focused on, many of the key metrics surrounding business investment in the United States really have been favorable. It demonstrates health; it demonstrates optimism.

So one of the most widely covered metrics in the business world is PMI, the Purchasing Managers Index. It's that chart that's on the bottom right of the slide that you're looking at. This index is an indicator of the economic health of the manufacturing world, which is that blue line, and the non-manufacturing world, which is the orange line in that chart. So each index is reflective. It's a survey of business conditions. And anything over the metric of about 50 demonstrates expansion in the economy.

So looking at that chart, you can see as of late, both of those metrics are well above the 50 threshold. What's particularly interesting is for the NMI, that orange line, that line has been consistently above that 50 threshold for basically since the downturn, so since 2009. So we're seeing significant optimism among those surveyed, among both sectors of the economy, both manufacturing and non-manufacturing, as to health and optimism.

Another way of looking at business health is the NFIB survey. That's demonstrated by the chart that's on the bottom left of that slide, the capital spending index. So this really projects anticipated capital spending expectations by small businesses. The number of respondents expecting near-term capital spending is above historical averages, as demonstrated by this chart. So the average is 23.3% over the past 10 years. We're closer to 30%; we're in the 28% range. So again, suggesting investment, projected growth within the business community.

And probably one of the most under-covered but probably the most interesting metric, at least from my perspective, is the business to sales ratio. So it's the inventory to sales ratio that's in that top right corner. It measures the number of months that it would take a business to sell down the inventory that they have on hand. So as the ratio increases, it suggests businesses are essentially accumulating a stockpile of goods, really with the expectation and anticipation that there's going to be future sales coming down the pike. So, really, a long-winded way of saying that there is an undertone of confidence within the business community that we expect going forward.

So looking at the flip side of that, slide 13, is the consumer. So on the consumer front, sentiment remains strong. So these four charts really cover four different avenues, but really tell a very similar tale. Consumer sentiment remains strong. The trend is continuing upward, and it's driven by a host of drivers, really, that's shown in these slides. The unemployment rate closed the year at 4.7%, which is a far cry from what we saw in October of 2009, when we peaked at 10%. The January new jobs report, which just came out, showed an increase of 227,000 jobs. Additionally, the average hourly earnings has increased every month since December of 2014.

Consumers do continue to focus on saving. They are saving at a modestly higher level than what we saw prior to the recession. But most analysts' perspective is that when you're seeing a consumer reach a threshold where they feel that they have a decent amount of savings in a safety net, so to speak, they'll spend the rest on discretionary income. So the trends are moving in the right direction, certainly, to fuel a confident consumer, which really does lead to consumer expenditure.

So the next slide has been something of an elephant in the room for a while — oil prices. The positive trend there is that we really do believe that oil prices have stabilized. Despite what we can really only describe as enormous challenges in the oil and gas sector over the past few years, optimism for 2017 and certainly beyond does appear to exist. This is particularly seen domestically. Rig counts are increasing, the natural gas sector is even driving the U.S.'s position as an exporter. So the supply and demand imbalance within the oil and gas market really is projected to tighten. Most analysts believe that this equilibrium is going to be reached in 2017 at some point as demand does continue to grow. Additionally, the production cut agreements that we saw within OPEC and non-OPEC members really can help reach that targeted equilibrium level.

So the tough times over the past few years within the oil and gas sector has led to efficiency improvements. So if there is a silver lining in all of this, potentially it's that. The participants really, in the industry, went into something of a survival mode. They shifted strategies and ways of doing business. They really learned how to operate in a lower-cost environment, a lower-price environment, during the downturn, and so they focused on a lot of discipline and a lot of operational improvements. So the change in this mentality is going to have somewhat of a staying power, even as oil prices show signs of increasing.

So as a testament to longer-term industry prospects, and especially since we're M&A bankers and we're here to talk about it, there's been an uptick in M&A activity within the oil and gas sector already. Numerous oilfield services have also announced — service providers have announced that they're in process of pursuing IPOs. So this even underscores a further sense of confidence in the market, and that sentiment certainly has stabilized.

So another topic that people have given ample consideration is the threat of a recession. Slide 15 touches on what the sentiment around the risk of recession in 2017 and beyond really is. Fears for dipping back into a recessionary environment are continuing to ease, which is obviously the positive trend. So looking at many of the key economic indicators, which is that very detailed chart on the right, so hopefully, you can see it when you're looking at it, but it really shows economic indicators across labor, housing, consumer confidence, equity markets, and it compares them from where we were at, at year end 2016, to where we were pre-recession, which was year end 2007. Virtually all of these metrics, you can see, are circled in green in the column for December of 2016. So we're suggesting they are at or above where we saw levels pre-recession in 2007. So again, continued growth, continued positive momentum.

Additionally, one of the Fed's indices, which is the chart on the left, the Financial Stress Index, it remains below zero. This suggests low financial market stress and certainly an overall healthy economic operating environment. So when coupled with the sentiment of these concepts as well as some of the Fed meeting notes which were released in early February, I think the broader undertone, again, is that the threat of a recession is somewhat in the rear view mirror.

So flipping ahead to slide 16, again talking about inflation, this is a theme that's continuing to be discussed regularly. Many analysts that are closely tracking it are becoming increasingly vocal about inflation-related impacts in 2017 and potentially beyond. As demonstrated in the chart on the left, inflation rates have been modest over the past few years. Price traction has gained in momentum recently, and most trends just view these levels at a comfortable inflation pace. The Fed has historically targeted inflation at about a 2% rate, which currently we're at 2.2%, as demonstrated in the chart on the right. And the Fed is expected to really manage that level going forward with respect to any pending interest rate increases, and certainly any other monetary policies.

So as noted before, the President's plan for a fiscal stimulus and tax cuts are expected to boost GDP, potentially by even as much as a full percentage point. But it is really reasonable to assume that any of these initiatives and programs will bring some inflation, and so the Fed's going to obviously be keeping a close eye on that and managing appropriately.

So slide 17 touches on the U.S. dollar. There has been significant movement, strong movement against a number of major currencies, particularly since Trump's election in November. We saw a significant shift in the market following that, as demonstrated by the chart that's on the left. But as the new administration continues to get settled, I think some of the implications of the policies that Trump highlighted while on the campaign trail is going to have an impact on FX rates going forward, the magnitude of which really does remain to be seen. There's been a slight back-track in some of the rates in early 2017 relative to what we saw at year end 2016, as certainly the tone of the administration, some of the messages being conveyed and, again, we have people kind of adjusting into a new normal continues to settle.

So the Federal Reserve actions, that's another topic of conversation many want to think about. In December of 2016, the Fed increased rates for only the second time in the past decade. So as the economy continues to remain on steady footing, inflation's again around that 2% mark, many are obviously questioning when the next round of rate increases is going to take place. At the end of 2016, you heard people — analysts, I should say — estimate that the Fed would be using rate increases of anywhere between two and three times in 2017. So as we move forward into 2017, it's looking as future increases in the year are going to be on the lower end of that initial estimation. At the conclusion of the February Fed meeting, the statement was basically identical to what was seen in December, suggesting that there's no real intention of raising interest rates again, and in certainly the upcoming March meeting, deferring to what we saw in January.

So in a slight deviation from that, Janet Yellen just prepared remarks in Congress about two weeks ago and kept the possibility of a March interest rate alive. But we still think the Fed is going to be unlikely to resume any tightening before June.

So the general consensus of all of this points to the belief that the Fed is going to end up tightening significantly in the second half of the year at the earliest. But most think that the Fed's going to be really taking somewhat of a wait-and-see approach as they get more clarity around the fiscal stimulus from the Trump administration. And additionally, that's going to continue as that stimulus works its way through Congress. So until that time, I think it's reasonable to assume the Fed is not going to commit itself to any aggressive interest rate policies and changes going forward.

So again, another elephant in the room, geopolitical dynamics. I won't spend too much time on this slide, because I think, candidly, it's slightly depressing. But the optimist in me has said that the economies continue to see positive trends, despite a lot of the themes that are outlined in this slide over the past few years. So while the risk of an event for any of these representative themes does exist, and perhaps a few others that maybe we didn't even include, the world markets really did seem fairly resilient throughout 2016, in spite of a lot of the broader threats that we saw in the world. So unless there's a significant development, I think the expectation is that we'll continue that pace and that trend, really, as part of the new norm.

So moving to slide 20, financial market indicators, I won't spend too much time on this slide because we want to get to, really, the meat of the presentation. But in short, the financial market trends are all positive. We're seeing a significant trend in the right direction, obviously, as demonstrated by the Equity Indices chart on the bottom left. You saw a significant uptick over the past few months. The Treasury yields are moving upward. Commodity indices are starting to settle. So again, positive trends that are occurring in the right direction.

So the last slide of this section before I move into the M&A market really just touches on an economic forecast. PNC is privileged to have very, very bright individuals within our economics department that touch on a number of economic areas, and this is the economic outlook that they publish every year. So I'll direct people to that first line — the first gold line, I should say — just at the top, showing economic planned GDP growth. So you can see, again, ranging in that 2% to 3% range for 2017 and 2018. So slow, steady growth, and that's really going to be the trend going forward.

So flipping to the next section, we're obviously going to dive into the state of the M&A market. The first slide in this one, I think, is one that's very compelling. When you look at it, I think it's somewhat actually shocking to see just how much M&A has evolved. This chart goes back to, obviously, a far cry. It goes back to 1895. But really focusing on the last even 30 or 40 years, you can just see how much the M&A landscape has really shifted. You've seen it become an increasingly prevalent and popular activity throughout North America.

So what this chart demonstrates not only is the growth and the continued trend of M&A activity, but also the varying kind of areas of economic growth, where you've seen waves of M&A activity that's been coming. So over the past four years — or excuse me, 40 years — there's been four peaks of M&A activity, highlighted by those gray circles. Three of the four were in the last — the fourth, I should say — three of the four really have been followed by steep declines. So that is as closely correlated to the broader economy. It is tied into recessionary environments, and M&A is somewhat of a lagging indicator of what we see within the economic environment.

So with that, I'm going to actually turn it back over to Bill. He's going to drill into a little bit more of the factors that are driving the M&A environment

Bill Watkins: This slide on 24, I'm going to ask you to look at quickly and then look away, because you might get dizzy with all the colors and arrows. But what this really does on the left is illustrate what some really key themes are that drive M&A over time. And I would just have you take your eye to the far right, looking at the green bar, 2013 to present.

We're in a democracy, so I got outvoted here. I wanted to put an arrow to go up instead of a question mark around political landscape. But we tend to think that right now, most of the variables that are helping facilitate a strong M&A environment we didn't really have over the last seven years are in place for a very strong 2017 and likely beyond, absent some large exogenous event that none of us can forecast right now.

As you look at transaction volume in North America on slide 25, you see 2016 on a preliminary basis, but good data still is rolling in through various sources we have. It was really the highest level since coming out of the recession, at roughly north of 11,350 transactions, so a post-recession high. You can see, if you follow your eye to the right, the fourth quarter of last year was particularly strong. The backlog, as I said earlier, in the first quarter of 2017 looks healthy.

This is all great, and we're going to get into some fundamentals on the qualitative side that are helping drive this. But one thing we would say, though, is despite the great market environment for M&A, we're still left scratching our head a little bit, because as you look at 2007 and 2006, that environment, and if you go back even further in 2000 and prior to that in 1998 and 1999, these were years in North America where we saw much stronger M&A volume. And we frankly think at Harris Williams and Company the fundamentals today are better than they were then. We just haven't seen as many sellers come to market yet, and we'll get into that a little bit later in terms of the final section.

On a global basis, the developed countries still continue to drive M&A. You see here on the pie chart on the bottom right — I'm sorry, the bottom left — North America in particular, western Europe, you're talking about north of 60% of total M&A volume. That trend, and you can go back 15 to 20 years, is fairly consistent, maybe moves a few percentage points, basis points, here and there. But nonetheless, North America and Europe continue to drive M&A. Nonetheless, we have seen much more interest from firms in Asia, particularly China, looking to invest in the U.S., and continue to grow.

Private equity, as many of you know, is a big part of the M&A environment today. If you look on a global basis to the chart on the right, from a fund-raising standpoint over the last few years, two of the top 10 firms were global firms in terms of raising capital. And look, you see these names on the list — the Blackstones and KKRs of the world, CBC and EQT, a very sizable business globally driving private equity

Larissa Rozycki: So looking at M&A activity by industry sector, we've really seen deal activity increase across most industries as a result of the M&A environment that we're in. That analogy of, "A rising tide lifts all boats," certainly is applicable here. What's so interesting to me about this slide when you look at it, it breaks down acquisitions by strategic acquirers on the left, you have the private equity community in the middle, and then the aggregate deal activity on the right.

And what's been so interesting over time, when we were dealing with the recession, we saw a lot of, for those industries that could actually get deals done, you saw a lot of safe industries being ones that were going to be seeing the activity. You saw healthcare, you saw some consumer-based companies being acquired. But as the market has continued to strengthen, you've really seen a lot of activity increase across all areas.

But what perhaps is the most compelling is if you actually look at the middle pie chart with the financial investor acquisitions by industry, it actually does mirror the strategic acquirer pie chart, to a certain extent — more so than it ever has in the past. And what that really demonstrates, I think, is the fact that they are willing to look at deals that have historically been less appealing to the private equity community, ones that typically are more strategic by nature because you're seeing more synergies, that kind of a concept. So you're seeing a more aggressive pursuit by certainly the private equity community to expand into areas that you haven't seen previously.

So that said, strategic acquirers are always going to continue to carry the day by way of M&A activity. They account for the overwhelming majority, especially in certain sectors, as I had mentioned, where you see synergies — energy, materials, et cetera — but certainly, private equity is not to be ignored. I think the private equity community, as it states here, accounts for about 15% of all activity in the M&A world.

Bill Watkins: So when you think about factors driving M&A today, clearly, as Larissa walked us through the macroeconomic environment, we're not seeing growth rates over the past few years, or projected, being in that 3.5%, 4% to 5% growth rate. So most folks today running businesses, many of you on the phone, are finding ways to augment what would be lower organic growth through transactions, through M&A. So that's a big part of the qualitative drive.

Part of the quantitative drive for M&A is really the pull of capital out there across the spectrum. I'm going to spend a little bit of time talking about the debt markets and that valuation equation; leverage is a big piece of it. If you look at slide 28, what we've done here is just put some data on the page. The graph on the bottom left really talks about leveraged loan volume. So again, this is for dividend recaps, and this is mostly for M&A. This would not be your working capital kind of facilitation in normal day-to-day business loans.

You look here and you see some of the quarterly spikes that can happen just when large M&A and large deals come to market. The most telling from this data, however, is really the growth in the institutional loan market. The blue bar in that chart represents institutional lenders. So these would be folks like Antares, Ares, large companies out there that are really helping private equity firms facilitate M&A, whereas the orange bar represents the pro rata market, which is more the traditional bank market. And you can see here today that really, within leveraged lending and within M&A, institutional lenders continue to dominate, and those institutional lenders continue to grow and grow. They're raising more capital through sophisticated means in terms of CLOs and other investors.

Now, what that has done, if you take your eye over a little bit to the right in the leveraged loan market with that increased competition, that does lead to some pricing that's a little more issuer-friendly. It also leads to some structures that over time can be also issuer-friendly. We just happened to pull out covenant-light loans here to highlight. And you can see the marked increase over the last few years in covenant-light activity. Again, this is not every loan in the leveraged loan market. Not every private equity-backed deal or large corporate-backed deal is going in with a covenant-light deal for M&A. But it does illustrate that we're getting back to a stronger market across the board in terms of leveraged lending.

Now with that, in the more traditional pro rata loan market — banks such as PNC and the like and their competitors — what we've highlighted here is the Federal Reserve Senior Loan Officer Survey. So these are the folks that just question credit professionals at banks about how they're feeling on a monthly basis, about their portfolio, about their lending strategies, et cetera. And as you see at this page, over the last few times — back five times, in fact, that the survey's been completed — we've been in red, so we've been in a tightening mode.

So I think what you're, if you go back to Larissa's comments about industry, I think what we're seeing here is there's still some challenges in the oil and gas market, and around energy there's still some other pockets that lenders are a little more concerned about. And I also think it just gets back to where we were for most of 2016 from a nation in terms of just question marks about the next administration, the election, what was happening globally. I think that led to just some quietness and some reflection about how we want to continue to build portfolios, loan portfolios within banks.

I don't think, if we go out here, we're going to see some major contraction in the lending world. I will tell you from a Harris Williams and Company experience, we're certainly not seeing that in the institutional loan market. And I can also tell you, just by trafficking with other, more commercial lenders, the focus is on growth today

And then again, institutional trends. I'll just go through this quickly, and I'll just say that virtually 90% of the transactions we're working on right now at the private equity group has some form of private or club deal being put together. The days of the broadly syndicated loan transaction in M&A, they do exist for corporates, but they don't necessarily exist in the private equity world. Everything is being clubbed together today. Folks have relationships. We're also seeing, while not on this page, a significant amount of unitranche financing across the board, where one lender will just take a whole strip of the capital structure for simplicity and ease in terms of getting the transaction done.

So again, you put all this together, and we're talking about capital, that piece of the pie on the debt side has been very strong. And then thinking through the equity piece on 31, this is just evidenced by the public markets, clearly returns have been very strong. I wish my personal portfolio kind of looked like some of those numbers I'm seeing here on the page at the bottom left. But nonetheless, the markets have been very strong.

The S&P, people continue to question. You get a lot of analysts on TV talking about, "How can we go higher? We had another dial high today. This has to end soon." But I've been doing this a long time, been working for a long time in finance. We're sitting here at a PE ratio, call it 25 or 26 times. Yes, that's ahead of the 20-year average, but it's still well below where we've seen other peaks in the market. So we've had to think that on the public equity side, there's still room to grow.

I think, interestingly, on 32, what we've done here is kind of break out a five-year return around a variety of sectors and then compare that to returns to the same sector since the election. And I don't want to say it's almost a complete flip, but if you start on the five-year period, you see consumer discretionary, healthcare, staples, those sectors distancing the traditional S&P 500, and in some cases, really outdistancing materials, utilities, the energy markets over that five-year period. Then if you revert to where we've been since the election over the last few months, financials, of course, have been the big winner. And that's really around this expectation that the regulatory environment will change and be more beneficial for banks and other financial institutions.

And then you've seen the plays around the industrial sector, the materials sector. Again, believe that a lot of what Larissa was talking about earlier, believe that we're going to see more domestic spending around areas such as infrastructure. So that's where the movements have been. But nonetheless, we tend to think the broader equity market should be pretty strong throughout 2017.

Larissa Rozycki: So what does all of this mean from an M&A perspective, especially around buyer sentiment? Focusing, since Bill was just touching on the equity markets, focusing on strategic buyers, it has been, over the past few years we've seen significant cash reserves on strategic buyer balance sheets. We currently see nearly $1.5 trillion sitting on the S&P 500 alone. That's just representative indices relative to what we see from the broader strategic buyer universe.

That's a significant amount of capital. They've hovered around that level for a period of time. What's interesting is about 35% of that cash is held overseas. So, obviously, another elephant in the room is really around the repatriation that Trump has favored for the cash that's held overseas. What would companies be able to do? Should they be able to get some form of a tax holiday and bring that cash back domestically?

Certainly, M&A is certainly an option with that. We would expect M&A to be an option with that. What's interesting, I think, in addition to the cash balance, is really the chart that's on the right and talking about leverage levels. Despite the fact that there's a lot of cash on the balance sheet, leverage levels do remain modest. Companies, strategic buyers, really do have ample capacity on their balance sheets to finance M&A transactions.

And I think especially when you think about the public markets, when you're looking at public companies that have expectations to manage from a Wall Street perspective, they have revenue growth estimates, they have earnings estimates. When you're in somewhat of a tepid GDP environment, the only way to achieve growth is through acquisition. And when you see strong equity markets, that essentially gives strategic buyers, especially publicly traded strategic buyers, more confidence and more ability to pay, to achieve those acquisitions successfully and certainly reach the metrics that are expected of them by Wall Street.

Flipping to the next slide, this touches the flip side of it with private equity. The private equity appetite, which Bill has alluded to, certainly buoyed by the leveraged markets, the private equity community remains extremely aggressive, and it has a strong appetite for M&A activity. I mean, at the end of the day, they're in the business of buying and selling companies as an industry.

So at present, when you look at the chart that's on the bottom left, this is something we refer to as dry powder. Essentially, it's capital that is available to invest for the purposes of pursuing M&A transactions. You leverage that 3 to 1, you're looking at $1.5 trillion of capital that's being able to put to work from an M&A perspective with respect to private equity.

So you're seeing the private equity community come out. They're being increasingly aggressive. We at Harris Williams, on an anecdotal perspective, have seen creative strategies for private equity firms to try and differentiate themselves when they are pursuing potential clients. We've seen all-cap transactions. We've seen creative transaction structures. Again, they're looking to deploy this capital, especially for companies that are very attractive and have positive trends ahead of them.

I think kind of reinforcing that theme is the chart on the right with respect to the equity contribution. Most lenders, as that box is highlighting, show approximately 35% equity contribution for LDO transactions. What's interesting is that, again, you're seeing the lines in that chart move higher than that minimum, that minimum of 35%. So you're seeing a little bit of an over–equitizing of M&A transactions. You're seeing that, again, private equity looking to figure out how to pursue deals aggressively and certainly carry the day.

Bill Watkins: So everyone always wants to talk about multiples, right? So we've just spent some time talking about the lower-growth organic environment and then this real capital position of equity to debt helping to propel valuations. You see here on 35 a time series that's illustrative of enterprise value at different levels — at the low end, less than $25 million of value; on the high end, north of $1 billion. And what you'll see here is really a stair-step function on size.

Now, this includes every industry except real estate and FIG, so we're not including financials in this. So this just gives you, again, a snapshot. But what I would also tell you, and many of you know this on the phone who have been through M&A processes, a multiple is the result of a very efficient and strong M&A process, and it's the endgame. It's not necessarily where the market median was in any of these cases. So just be wary of that as both a seller and a buyer, that in this environment, everyone does want to talk about multiple, but the process is exceptionally important to kind of drive to that multiple

I'm just going to spend a few minutes, because I'm kind of out of time here, want to be thoughtful on the Q&A that's coming in, just where do we go from here? On 37, our business is entirely tied to the economy, so the correlation coefficient is pretty close to 1 to 1. And if you look here over time, every time there's been a strong growth in M&A, the decline of M&A has been led by a recession, an economic recession. Well, here we are in seven-plus years of an expansion in M&A, and fundamentally, as you heard from us today, we don't see a recession on the horizon. So we think we're kind of in another eighth year, maybe even a ninth year, starting to resemble a baseball game. And hopefully, at some point for our profession and for our clients, this turns into an extra inning kind of affair where we see a number of years, perhaps even a decade, of strong M&A, again really being propelled by the capital that we have in the system right now.

There's some things — politics. I try to shy away from this personally, but you can't walk away from it when you're thinking about a transaction. There's certainly things that are happening in Washington right now with the new administration. We tend to think, and what we are hearing, that the regulatory environment will be less burdensome. I think that's great across the board. There are some things that we're hearing that are kind of pros and cons from a tax standpoint. Larissa mentioned repatriation. That's certainly a fantastic alternative to bring capital in for companies and also use that capital to invest in other areas

But there's also some things we've heard about, events about potentially the interest rate factor's actually going away, et cetera. So there will be some noise around this. What I'll tell you, 39 and 40 kind of illustrate additional noise and questions people have. In our experience, creativity, entrepreneurship, capitalism — all those concepts are kind of water, and they eventually find the crack somewhere. So regardless of the hurdles that are put in place or hurdles that are removed, we tend to think that we're in a pretty robust environment right now. I'm not trying to be Pollyanna, rose-colored glasses, and say that it's a perfect world, but I think most business owners and most professionals today will not allow whatever's happening in Washington to really affect what they're trying to do on a day-to-day basis to drive their strategy of growth.

So again, 39, 40, I think we can just skip through quickly, just some questions that people are looking through as they think about deal activity. But I do want to say on 41, through some various surveys, and Larissa touched on this earlier, the middle market's still where it's at. Having said that, you're going to hear me talk in a minute about large corporate deals and big megadeals. But nonetheless, all of that drives and trickles down to the middle market from an M&A standpoint.

You see here on slide 41 the vast majority of the transactions are below $1 billion of enterprise value, and that's going to continue. That doesn't mean on a weekly basis, you won't turn on the news or open up the newspaper — I just dated myself there, didn't I? — or look on your iPad and read a story about a multibillion-dollar transaction. But nonetheless, the heart of the activity where people want to grow is really around the middle market. There's many more opportunities out there, arguably, either easier to integrate and finance, et cetera. So we tend to think that's going to continue.

Forty-two, looking at our business, I touched on this to kick things off. Our backlog is as strong as it's really ever been at Harris Williams and Company. We sit here today in mid-February. We're very optimistic about where we will end the year. Now, a lot has to happen. More pitches have to come in. Our teams have to do the work to get deals closed. But as we talked about the market fundamentals, they're very conducive right now, and we're pretty optimistic about how 2017 will play out.

I did mention on 43 a little bit about the megadeals. But even though we don't participate as a firm in these transactions, and I doubt many of you on the phone do, this is awesome when these kind of transactions happen, because it's just evidence of the kind of market we're in — the belief in the businesses, the belief in capital and capitalism. And we tend to think more and more of these transactions will occur, given the things we've talked about, about stockpiling cash, the need to spend that cash. Frankly, if you talk to anybody that's a board member of a public company, the choice between an M&A deal and a dividend to shareholders, it's a pretty easy choice to make. So we tend to believe we're going to see more of these megadeals happen, very transformational.

And then what that also does is lead to divestiture opportunities as these companies continue to rationalize portfolios. And again, that becomes a middle-market transaction, or series of transactions, that the private equity universe and the corporate world can continue to attack.

So to wrap things up on 44 before Q&A, a lot of words on the page, but really, the key themes around capital, financing market, the economy, news headlines — I mean, all of these things are very important. But we would tell you that the real underpinning today is the capital environment. And across all capital markets, debt and equity in particular are looking for a home.

And then again, that thirst for growth. It's not happening organically; we doubt it will in the near future. And going back to the halcyon days of, again, the 5% to 6% GDP growth, even if the regulatory environment changes, we don't think the pendulum is going to swing that much to encourage some of that behavior that we saw 10 years ago. So we are in the economic environment we're in, but we are buoyed by just trillions and trillions of dollars of cash.

What we haven't seen because of that cash and multiples being at highs across most industry sectors is, again, the volume coming to market. And I can get on the soapbox or I can give you anecdotal evidence, but like today, many business owners are having a great time. You know, they've been building a great business, investing in management teams, living healthier lifestyles. Frankly, we tend to believe that the recession, while it seems so long ago, was a little bit of an Ali punch to the stomach of many business owners. And in that process, they kind of rallied their family behind the company, and now they have more succession planning in place than they may have had 10 years ago.

So today, to acquire a business from a family, a founder, an entrepreneur, it's not just about showing up with a blank check and the biggest price. A lot of people can offer that. It's really about making a legacy and opportunities and growth for that business going forward that helps you win as a buyer.

So I'm going to shut up and kind of — we've got some time here. I'm going to turn it over to Matt for some Q&A.

Matt Francati: Yes, thanks, Bill, and thanks, Larissa. So we would now like to open up the session for questions. As a reminder, you can ask questions using the Q&A window located on your screen. If you do not see the Q&A window, simply click on the Q&A widget found in the lower center portion of your screen.

Let's take a look at our first question. So, Bill, I'll ask you to address this. Now that Brexit, the US election, and other risk events are behind us, what obstacles could face the M&A markets in the next 12 to 18 months?

Bill Watkins: Well, I think I touched on a few of these. I may have indicated it wasn't an obstacle in some cases. But we just don't know yet what's going to happen with the Trump administration. We think, and what we're hearing, is that it will be positive, but we're not quite sure what's going to get through Congress and when. So that's clearly still on the horizon.

But other than that, and those questions, the geopolitical issues have been there, so it's not as if four or five, six years ago, they weren't in the environment to lead to any questions around M&A. They're always there. So I don't necessarily see that as being some kind of risk. But I don't want to rule out any black swan event that could kind of happen that none of us could see. But other than those kind of peripheral issues, we don't see anything here at Harris Williams and Company that leads us to believe that there's some major hurdles.

Matt Francati: Got it. Larissa, regarding roll-up strategies of private equity firms, are we seeing more demand from private equity firms to build on their platform of investments until they have they have an event?

Larissa Rozycki: I think that's certainly an ongoing theme. Private equity, that is always their business model they adopted. So they will look for nice platform investments that can grow and then stand alone. But to the extent that they can enhance the business in a portfolio that they have, it's always going to be something that they pursue.

I think that when they're pursuing potential roll-up strategies in the environment now, it is something that entrepreneurs are cognizant of. I think private equity gives an option for a lot of entrepreneurs that are looking to be quote-unquote rolled up for other opportunities for liquidity. There could be potentially a public exit. There could be opportunities to participate in equity going forward. So we are seeing a lot of that. Private equity continues to be an appealing liquidity alternative for a lot of entrepreneurs. So I think that as the market continues to be aggressive and as private equity continues to have the capital, roll-up strategies are going to continue to be a meaningful part of what they pursue.

Bill Watkins: Matt, what I'll add to that is historically, I think we've heard anecdotally that the add-on transaction might be at a lower multiple than the platform. But across certain industries, that may be the case. But again, the environment we've been in the last few years, I think the rising tide has lifted multiples across the board. So there's been a number of private equity firms that have told us advantage is just as challenging as pursuing add-on strategy today than it is to go out and then find a new platform in terms of the processes, the efficiency, and the challenge evaluation. But look, the bottom line of any private equity firm, any institutional investor in the equity side, is to buy a business and grow the business. And M&A will be a big part of that.

Matt Francati: Got it. And Larissa, you touched on consumer spending in the presentation. And how does the increase that we've seen in consumer spending correlate to consumer debt, and what does that mean?

Larissa Rozycki: Well, when you think about it from a debt perspective, Matt, there's a healthy level of debt when you look at what level of (inaudible) and when you think about mortgages, you can think about those kind of debt levels. And again, that's healthy. You can look at credit card transactions. I know there still is an ample supply. I think I saw that the average consumer now has something about to the tune of about $4,000 in credit card debt in the average household.

So I think that when we think about our consumer, I think there is a focus on consumers continuing to try and live within their means. But as they are increasingly confident that they have job security, that the economy's improving, you will see them spend. So again, trying to strike that balance between when they're spending what they can afford and maybe over-stretching. I still think that we're in a better position than we were pre-recession, certainly.

But the consumer is going to be, obviously, the lifeline and the heartbeat of the economy. Based on what we've seen in terms of how they've moved from, say, 2013 to present, there's really no indication that the consumer's going to take the foot off the gas pedal any time soon. Maybe they're thinking about — they might think a little longer and harder about some of the bigger-ticket purchases — you know, buying a car, buying new appliances. But they're not really batting an eye at picking up a shirt at the mall or at Amazon now. That's where everything seems to be going. Or buying that cup of coffee at Starbucks. So I think it depends, based on how they're spending is really focused and where their hot buttons are.

Bill Watkins: Yes, and with the unemployment numbers where they are, where the rates are where they are — many of you probably saw housing numbers today — I think we still see some runway there.

Mark Francati: Great. And Bill, what are your views on international M&A trends? I know we touched on it earlier, but do you anticipate continued interest in cross-border transactions, given the concern for slowing economies in emerging markets?

Bill Watkins: I would probably take emerging out of it and just say this concerns, really, a lot of global markets. But the short answer is yes. Virtually every one of our M&A processes were driven by clients who were allowed contact. Global buyers have a lot of interest across the board, whether it's Japan, whether it's China, whether it's all the countries in Europe. There's just a lot of interest right now because the U.S., as we saw in the data, continues to be the economy and the driving force. And we still view, despite again, what some may view as a little bit of an upheaval in Washington, still a pretty safe haven overall compared to many of the other economies. So we don't see that slowing down at all, Matt.

Now, the challenge, we don't see the interest slowing down. The challenge is being on kind of equal footing, because I will say that the North American M&A market is — I may sound like an ugly American by saying this — but it probably is the most efficient market globally for transactions, particularly the way that we tend to execute processes. And we see more global firms trying to acclimate to that, using advisors, particularly in certain emerging markets like China, for example. But it's just going to take more and more time for them to get as comfortable going through an M&A process in the U.S. as maybe they're used to in their own country.

Mark Francati: I think we've got time for one more question out here. I'm looking at the time. And I'll ask Larissa. You mentioned a little bit about sectors outperforming others since the election. Do we see any pent-up demand for M&A activity in certain sectors, such as industrials or materials, commodities?

Larissa Rozycki: Absolutely. I think as we continue to see economic health across all sectors, there certainly is pent-up demand. You look at oil and gas, for example, over the past few years, everyone was largely focused on just keeping their doors open versus thinking about strategic growth. So now that we're starting to see comfort and confidence in the health of the industry sector, they're going to start to look towards strategic development.

So there certainly is opportunity for that, and that's, I think, when you get into a healthy M&A environment and a healthy and strong economy, those sectors that oftentimes face the headwinds — industrials is one, aggregates and minerals is one, oil and gas is another — those tend to be the first to somewhat see the slowdown come out of the gate. So as we continue to remain strong, again, across all sectors, we're very optimistic that M&A is going to be something that everybody's going to be thinking about.

Mark Francati: Great. Well, we're just about out of time today, but we'd like to thank Bill and Larissa for an excellent presentation, and we'd especially like to thank all of you for attending. We hope you found it valuable and insightful.

A PDF of today's presentation, as well as a CTP certification credit and a recent Investment Outlook Update, is now available for you to download from the green Resource List file folder widget in the lower center portion of your screen. You will also see a link to a short survey. Again, your feedback is important to us, and we'd greatly appreciate your thoughts of today's session and presenters. This concludes our presentation today.

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