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A Perfect Storm for Sellers

We are in the vortex of a perfect storm for sellers. We have observed an almost frenzied pace of investment, driven by the confluence of pent up demand, cheap financing and surplus capital—market conditions often compared to the last peak mergers and acquisitions (M&A) cycle in 2007. Investors have considerable buying power and are responding in kind using acquisitions to accelerate growth:

- Corporates are looking to M&A over organic expansion and facing increased pressure to match acquisitive competitors, despite rising purchase prices. Financial buyers are bidding at comparable levels to strategics, as continued pressure to put dollars to work forces private equity groups to be aggressive in auctions and bid up purchase multiples for the right assets.
- Lenders are supporting both groups with aggressive debt packages, as higher leverage pushes valuation multiples to near-record highs, evidenced by one to two turns of multiple expansion above historical averages. For the broader middle market, Standard & Poor's *Leveraged Commentary & Data* cited a median EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) multiple of 9.8x through the first half of 2015—up from 9.6x in 2014. The median EBITDA multiple for the plastics industry reached 9.0x in 2014.
- The U.S. economy is expanding and, longer-term, the impact of low-cost natural gas and re-shoring are forecasted to stimulate additional demand. Against this backdrop, the appetite for acquisitions is increasing, creating a healthy transaction environment for sellers.

Plastics industry M&A activity is accelerating in line with broader market trends. 2014 deal activity (based on number of transactions) was up nearly 20 percent with volume on par with 2007 peak levels. 2015 promises to be equally strong despite a slower first half, as liquidity continues to fuel deal making. News of bellwether transactions fill the headlines almost daily, illustrating that higher multiples are paid for quality companies that can bring scalability, a unique technology or service, or entry to a new market or geography:

- In June, Jarden announced the $1.35 billion purchase of The Waddington Group (TWG) at a 9.9x multiple of EBITDA, gaining a leading player in the premium and green packaging segments. TWG's green packaging segment is poised for double-digit growth driven by increasing consumer demand for environmentally-friendly products.

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- Also in June, serial acquirer A. Schulman completed the $800 million purchase of Citadel Plastics Holdings at a 10.6x EBITDA multiple, the largest of 11 deals in less than 6 years. The acquisition is expected to significantly expand Schulman's North American presence, almost doubling its U.S. compounding sales and establishing a new growth platform in high-margin thermoset composites, further advancing the company's strategy to expand in specialty applications and growing end markets.
- In May, TransDigm Group aimed for target Pexco Aerospace, a maker of interior plastic components and assemblies for the commercial transport market. TransDigm was attracted to Pexco's proprietary products, relationships as a sole source supplier and growing position in the commercial aftermarket. The $496 million purchase price valued Pexco in excess of 10x EBITDA. Including Pexco, TransDigm Group has spent more than $1 billion on three acquisitions so far this year.
- Also in May, Ontario Teachers' Pension Plan purchased Infiltrator Water Technologies for $530 million, valuing the company in excess of 10x EBITDA. The plastic tank manufacturer serves the large and growing wastewater and stormwater industries which are experiencing growth from increased spending on aging infrastructure and as plastic products take share from concrete and stone.

Large scale M&A activity implies more consolidation down the supply chain, where we see an active middle market and equally robust deal multiples.

End market drives value, and niche companies that can bring technology and capability expansion to advance innovation are in high demand. Medical plastics businesses, for example, are attracting high valuation multiples due to the above-average growth and margin profile, product and development complexity and high barriers to entry of niche markets.

Cyclicals like transportation and construction have made a comeback on the heels of improving market fundamentals. Investors shifted from a value-oriented approach to acquisitions early in the recovery to the full valuations observed in the market today as companies returned to a path of profitability and growth post-recession.

How long will today's favorable market conditions last? Lenders argue that we may be approaching the end of the current credit cycle, while an imminent hike in interest rates, albeit gradual, threatens to increase borrower financing costs. Given the billions in capital earmarked to finance transactions, these challenges may not be enough to slow down the pace of M&A; however, they could have a dampening effect on valuations.

Ultimately, company quality drives purchase price multiples, and there will be eager buyers willing to support healthy valuations. Behind every premium multiple you will find a seasoned, forward-thinking management team; culture of innovation; strong financial performance; and visible and quantifiable growth opportunities.