COMMENTARY

February 20, 2015

Dear clients and colleagues,

Quantitative easing continues to create an environment of cheap money. Profit margins for most US companies are approaching peak levels, if not exceeding them. A resumed confidence in the US economy has set the stage for the M&A cycle to pick up.

One might suggest that the US economy has been improving for some time and that M&A activity has already peaked. The US rebound, although in its sixth year, is still in the early stages of recovery. Capital spending has been low and the unemployment rate is improving. The unemployment rate could get even better as companies begin to hire again.

We think M&A activity is set to pick up in the coming years. Our thesis is very simple: companies are beginning to build up courage since the crash of 2009. M&A offers the best growth opportunities and an attractive yield, as compared to the current interest rate environment.

How was 2014 for M&A?

2014 was a strong year for M&A globally with deal volume up 26% - the third highest behind 2007. The US experienced its highest level of M&A activity on record and it accounted for 45% of global M&A. An important element that changed was the average size of deals, as dollar volume increased 2-3 times the increase in the total number of deals.

What about 2015?

YTD deal volumes have reached $38.1Bn and according to dealogic, this is the fastest start to the year on record. 2015 is anticipated to be another good year in global M&A thanks to low rates, high credit availability, and stock markets at high levels - at least in the US.

How does this impact our portfolio?

The accelerating M&A environment is positive for smaller companies. Their mega counterparts are willing to pay to acquire small and innovative companies that can provide positive long-term growth prospects. What's more, big companies seem to be diversifying the types of acquisitions they make. Larger, maturing companies do not have the same ability as small companies to innovate. Small companies have the capacity to adjust, create, and develop faster due to their nimble structures.

An offer has already been made on one our holdings this year. We also see many companies in our portfolio as potential targets for acquisition.

How else can we participate in the M&A cycle?

Over the last six months, we have initiated a position in three investment banking firms - one in the US, one in Japan, and the other in Europe. This week, we shall introduce you to one of the investment banks that we see as ideally situated to benefit from this trend. The company is Evercore Partners Inc.

Evercore (EVR US – $52.14)
http://www.evercore.com

Business Overview
Founded in 1995, Evercore is an independent investment bank and asset manager. It provides advisory solutions for mergers and acquisitions, divestitures, restructuring capital raising, and equity underwriting.

Evercore accounts for 18% of announced M&A volume amongst the top boutique/independent advisory firms. It has a strong and growing global footprint.

Target Market
This is a secular growth business given that over the last 35 years, each successive trough has been higher than the previous trough. Each successive peak has also been higher than the previous peak. The M&A cycle follows the economic recovery.

- Global deal value was $3.6T in 2014 vs. its peak of $4.6T in 2007
- Activity levels YTD are amongst the strongest since 1995

Evercore's Competitive Advantages

- 5.2% market share
- Competes on intellect, creativity, and relationships – No Balance Sheet risk, or need of capital
- Brand

Growth Strategy

- Hire senior managing directors
- Niche acquisitions for the wealth management business
- Equity and Debt Capital Markets

Management
Evercore has a strong bench, with Roger Altman as the founder. Ralph Schlosstein, the CEO, was one of the co-founders of Blackrock in 1988. Management together own approximately 30% of the firm.

Risks

- Reputational
- Market risk
- Low barriers to entry

Market Data
Market Cap $2.1B, P/E (2016) 13.8x, Ev/Sales (2016) 1.7x, Ev/Ebitda (2016) 6.1x, 5 year average sales growth 27.6%

Have a good weekend.

The Global Alpha Team