

## Merger & Acquisition Market Climate: Looking Back – Looking Forward

Things are looking up. At least I feel that way after a deal I'd been working on for a long time closed the week before last (AmTest Air Quality sold to Horizon Engineering), but that was 2 weeks ago, what's the market like today? We seem to be always looking backwards and extrapolating straight lines into the future, and I'll do a little more of that in this report, but after being in this business for a while you do develop a bit of a sixth sense for what's going on in the minds of buyers and sellers.

**Financial buyers**, e.g. private equity groups, always seem to profess an appetite for acquisitions, and with \$400 billion or more in dry powder they can do nothing less. They continue to be hungry for deals – both new platform investments and add-on acquisitions for their portfolio companies. Debt is somewhat more available now so the pace of their deal closings appears to be picking up. The common theme among this buyer group is that there is a lack of enough good companies in the market right now. I'm getting many more calls, e-mails, and requests for meetings from this buyer segment recently than I did last year at this time.

**Strategic buyers**, e.g. buyers in your industry, appear to be more active as well. It's unusual for them to seek out intermediaries looking for deals like the private equity groups do, but recently this has started to happen. Vice presidents of corporate development and CEOs have started to reach out to us and lay out their investment criteria just like the private equity groups have been doing for a long time. Many of these firms have raised good sized war chests and they're being pro-active about seeking acquisition opportunities. Why are they being so pro-active instead of waiting for deals to come to them? Again, there are not enough good companies in the market right now.

**Individual buyers** have been virtually absent from the market from the fall of 2008 and throughout 2009. There's not much data to track this buyer segment, but anecdotal information from Main Street business brokers indicates that most of these buyers were curled up in the fetal position with the covers pulled over their heads. However, recently these buyers have started to come back and indicate that they have enough confidence in the future to buy and operate a small business. To me that's a forward looking economic indicator of a market turn.

What about **sellers**? Many sellers who were in the market in 2008 and early 2009 pulled out of the market and decided to wait out the recession. Some figured to wait on the sidelines for their own businesses to recover so they could get full value for it. I had several such clients who are working hard to recover lost revenue. Others had businesses that did well in 2009, but pulled out of the market to wait out a recovery in market pricing. Pricing began to recover in the latter half of 2009, and one of my clients who did well in 2009 decided to take advantage of the situation, and we now have the company under a letter of intent for sale to a strategic buyer at a good price. Other prospective sellers have been sitting on the sidelines for years waiting for the time to be right. Of course, now in hindsight many can see that the right time was 2006 or 2007 when the stock market peaked. Market timing is tough in the stock market or in the private business sales market, but things are looking up again and maybe some of these owners will look around and notice that there are a lot of buyers in a marketplace that lacks enough good sellers. When that happens a lot of deals will get done.

**Looking forward** - Overall I'd say the volume of done deals will continue to build throughout 2010 and 2011. There are some structural things in the debt market that make me worry a bit about 2012 and 2013, a time when a lot of commercial real estate loans on high priced 2007 and 2008 real estate will mature. Refinancing those properties may be the next shoe to drop, and lenders might not have a lot of appetite for business acquisition loans at that time. Prospective sellers who wait too long might be in for another shock at that time. I hope I'm wrong about that.

## Looking Back – Historic Private Equity Group Multiples

I often cite the work of GF Data Resources. They analyze private equity group transactions valued at \$10 million to \$250 million, and they do a great job. In a summary report issued in March they reported on a 4 year history of buyout multiples and broke down the results for the “above average” companies. “Above average” meant growth over 10% and EBITDA (earnings before interest, tax, depreciation, and amortization) over 10% of sales. Here’s what they found in terms of EBITDA multiples.

	Multiples for Above Average	Multiples for Others
2006	6.1	5.9
2007	6.0	6.2
2008	6.0	5.6
2009	5.8	5.1

Recall that in 2007, the stock market set a record for pricing. At that time the run of the mill companies actually received higher multiples than the above average companies. Think back – it was a crazy time. It was just the right time to sell, when buyers were throwing around “stupid money.” By the end of 2008 that all changed. Above average companies received a 7% premium. In 2009 with the recession in full swing, above average companies received a 13% premium, and sold for nearly the same average multiple as they did in 2007 and 2008. The moral seems to be that even in a severe economic downturn the above average companies maintain their value, but multiples for other companies drop. If you have one of the above average companies, call me...please. We should talk.

Does anyone remember when the last recession ended and when multiples began to recover? I do. The turnaround happened in the fall of 2003. GFDR was good enough to provide us with a record that goes back to their founding in 2003. Here’s what the historical EBITDA multiples were for all deals:

2003	5.7
2004	5.9
2005	6.0
2006	6.0
2007	6.0
2008	5.8
2009	5.7

I reported that we saw an increase in multiples in the AM&AA Deal Stats survey during the second half of 2009. GF Data Resources saw only a slight increase in the fourth quarter of 2009, but still it was an increase.

**Looking back** to where we were in the latter half of 2003 and where we were at the end of 2009, I see some parallels. **Looking forward** it makes sense to me that 2010 and 2011 will be somewhat similar to 2004 and 2005 as we return to normality for business sale multiples. Whether you have an average company or an above average company, now is the time to begin preparing your company to go to market. They say on Wall Street that no-one rings a bell to tell you when to sell. Down here on Columbia Street I’m ringing our ship’s bell every day now.

If you want to know more about this topic, please give me a call at 800-240-4609.

## Looking Forward – CEO Plans 2010-2015

Pricewaterhouse Coopers issues a report called the Private Company Trendsetter Barometer that surveys CEOs of leading privately held businesses in the U.S. The report shows that most have plans to monetize their investment in these companies, and many plan to exit during the next five years. 38% intend to monetize the value of their companies within the next five years and 36% in 6 years or more. 46% intend to sell their business to another entity, 36% intend to transfer the business within the family, 12% are considering a management buyout, and 10% are looking at an ESOP. Firms with less than \$100 million revenue were noted as most likely to seek out a deal with a private equity group (60%).

The reasons were diverse, with 66% of CEOs seeking to monetize their business over the next five years citing the desire to create liquidity and diversify their own net worth. Only 28% cited financial difficulties. 43% cited retirement. Small firms were most likely to cite retirement as the primary reason.

**Looking forward** – more companies will be coming to market over the next five years. If owners wait too long there will be a lot of companies in the market competing for the buyers' dollars.

## Referrals

Thank you to all of the attorneys, accountants, financial planners, bankers, business owners and others who have referred clients to us. We greatly appreciate the trust and confidence you have placed in us. If you would like to refer a business owner to us for value consultation, business purchase, business sale, management buyout, management buy-in, or re-capitalization, please be assured that all of our services are totally confidential. Call me today at 800-240-4609.

Best Regards,

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