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Chilly M&A market

Most deals involve distressed firms

By Eric Decker, of SBT
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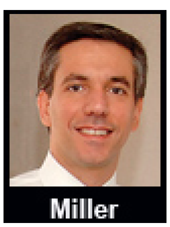
Merger and acquisition activity across the country dropped significantly during the second half of 2008, following the plunge of the stock market and the sluggish economy.

M&A activity fell about 38 percent in 2008 by the end of November, compared with the same period one year earlier, said Howard Lanser, director of M&A at Baird Investment Banking in Chicago.

“What is particularly chilling is that when you look at November (by itself), we’re down 86 percent,” he said. “That’s a staggering number. And the December numbers, while preliminary, are equally as bleak. We’re looking at a fourth quarter (of 2008) which will go down as one of the worst in M&A history.”

There are opportunities for mergers and acquisitions in today’s environment, but they are markedly different than the opportunities that were common during the market boom of recent years.

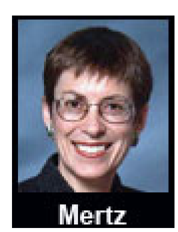


“Most of our transactions now are stressed or distressed,” said Ron Miller, a managing director at Milwaukee-based Cleary Gull Inc. “The majority of it is a result of financial pressures on some portion of the business.”

Cleary Gull is working on almost as many deals as it was a year ago, Miller said, but more than half of them involve distressed companies now, compared with less than 25 percent one year ago.

The number of distressed companies in the market today gives more opportunities for healthy companies with an appetite for acquisitions, Miller said.

“We’re chasing a number of deals where we’re representing the healthy buyers taking advantage of distressed assets,” he said. “It’s a good time to be a buyer if you’ve got cash. It’s a huge part of the opportunity this year.”



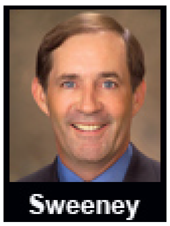
Linda Mertz, managing director at Waukesha-based Mertz Associates Inc., said her company has developed a specialized product division called its “Undiscovered Opportunities” division, dedicated to helping buyers find distressed assets to purchase.

“I’d say we’re in a period of great change and within this there is a lot of opportunity.

A lot of companies are pulling in the rungs and riding out the storm, but a lot of them are looking at bargain value assets," Mertz said.

"There are two primary themes in the market today – people who are hunkering down and are emerging strong and it's a good time to buy (for them)," Mertz said. "The other is people with too much debt and they're nervous. For those that have too much debt, they need to sell the horse before it dies. If you're not going to make it, look at your options while you have time. In this environment there will be personal tragedies that could have been avoided if they had proper coaching and started working more quickly."

'Life coaches'



Joe Sweeney, a managing director with Corporate Financial Advisors LLC, said his company is working with a growing number of interested buyers looking for distressed assets. His company is also taking a long-range approach to the current market.

"People think of investment bankers as those who put deals together, but we've gone from being investment bankers to life coaches," Sweeney said. "Our roles have really changed. If we can't get an engagement today, we can help coach (your business) in the interim so that when we get some clarity (in the economy) I can be the banker of choice."

Many private equity buyers are still aggressively looking for acquisitions, Miller said, because many of the public auction sales have dried up.

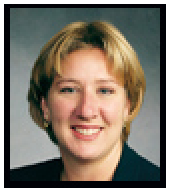
"Our total (number of deals looked at) for 2008 was down 12 to 13 percent," said Grey Myers, managing director with Mason Wells Inc., a Milwaukee-based private equity group. "The first half of the year was just below the first half of 2007, but the second half just fell off the table, especially after September. The phone is not ringing a lot right now."

The current low level of deals available in the market will continue for at least the first half of 2009, Myers said, but he does see some potential for a rebound during the second half of the year.

"As the year goes on, people will see that the world hasn't ended," he said. "We will see people start to get comfortable and we'll see some pick up in the second half of the year. It won't be as robust as recent years."

There are also some indications that banks may be more willing to help fund M&A transactions.

"If you want one bank and less than $20 million, there are local banks that are interested in growing their local footprint," Miller said. "They are conservative in the way they approach transactions but they are eagerly looking to add relationships where they are the lead bank."


Fox

Victoria Fox, managing director with Milwaukee-based Emory & Co., agreed.

“We’re already seeing some flexibility from banks – we want them to do it and they want to get deals done,” Fox said. “If you’ve got a good company and are willing to put money down (you can get financed). Gone are the days when you could buy a company with no money down. And you have to put more equity in the deal. That’s why strategic buyers will become more prevalent in the next round of M&A.”

No more easy money

However, there is no indication that there will be any quick return to the easy money and low interest rates experienced in recent years. Some banks are now asking businesses with an existing relationship to refinance all of their accounts with the institution when they want a new loan for an M&A deal, Fox said, which has put the clamps on some transactions.

“The banks are holding some deals hostage,” she said. “There are more buyers than you think in that category.”

Many buyers are tending to take a “wait-and-see” approach to any transaction now, Fox said, and want to see another month or two of financial performance from a potential acquisition target. That approach and the lengthy time it takes to bring a company to market and close a transaction could put off any recovery in the M&A market until the second half of the year, she said.

“Anything that we sign up now shouldn’t close for the next six months,” she said. “Some sellers will decide to sell in the next few months, but those deals will not close until the end of the year. It will be at least the second half of the year (until we see some rebound).”

Lanser is slightly more optimistic.

“Commercial paper is still anemic, but growing, and banks are getting more comfortable and confident with each other,” Lanser said. “2009 will not be a record year. But I do think that (we will be) in an environment that will be much more favorable to get deals done. I hope that we have weathered the storm and that there are calmer waters ahead.”

The current M&A landscape may look grim now, Miller said, but the groundwork is being laid for eventual recovery.

“We’re working with a lot of great companies who will do very well in the long run but are feeling the same pressures that are being felt by everyone right now,” he said. “This (recession) is very reminiscent of 2002. The banking and debt market was worse, the small market was worse, and lenders didn’t want to lend. This is a broader recession than the early 2000s, but on the corporate side this is very reminiscent. This recession has been very painful but companies are taking the appropriate steps to rationalize their costs, and in 2010 or 2011 we’ll come out of it very strong.”