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Merger and Acquisition Trends in an Economic Downturn

Is the recession over yet? Although many business leaders were optimistic that the worst was over in early 2010, there are many current signs that a second dip in the economy is underway, or that the recession never really ended. According to the National Bureau of Economic Research, the recession began in December of 2007. Since then, the level of merger and acquisition activity has been down significantly.

According to Mergerstat Review – 2010 Edition, merger dollar volume dropped nearly 60% during the recession and the number of deals has dropped around 40%. Some of the reasons I've heard for the reduced activity include the following:

1. Earnings are down, which often means that purchase prices are down. Many sellers are not willing to accept a lower value for their business, so they are waiting for a rebound before making their business available for sale.
2. Although interest rates are down, credit is not widely available from banks for transactions. Banks have changed their criteria for lending and in general are not taking as many risks as they had previously.
3. Public companies that have experienced a drop in their stock price now have less buying power as many would use their stock as part of the purchase price in acquisitions. And lower earnings at these companies means less cash to do deals.

There is a consensus that mergers and acquisitions will make a strong return once the economy shows some signs of recovery. A recent New York Times article mentioned pent up demand on both the buy side and the sell side of potential transactions. Some of the trends that support this prediction include:

1. Burnout in the ranks of baby-boomer business owners. Many are approaching, or are past, typical retirement age and are looking for a change.
2. Technological advances that are driving market consolidation.
3. Increasing interest in US companies by foreign investors, and
4. A buildup of cash held by private equity groups.

So what should you be doing now as a business owner?

If you are a business owner who is contemplating selling your business, there are a few things to do at this time.

1. Determine the current value of your business. As a Certified Valuation Analyst, I provide valuation information to many clients in various industries. I can give you an idea of the current

value of your business in this economic environment and provide information to predict value based on projected results of your business and an upswing in the economy.

2. Get control of your costs. If your sales have dropped, it is imperative that your costs be reduced. Sometimes this means a reduction in workforce or a reduction in benefits provided to personnel. These can be tough decisions, but value is ultimately tied to earnings, so improvement of those earnings, regardless of the economic environment, will be key to retaining or improving the value of your business.

3. Consult with an experienced business broker. We actually perform broker services for our clients through a related company. The benefit of using a broker like ours comprised of CPA's is that we can analyze potential deals from many perspectives, including the valuation perspective, the tax perspective and the accounting perspective. Recent accounting rules have changed the way acquisitions are accounted for and we are well aware of these new rules.

4. Set a realistic expectation on the timing of a sale. The timeline for deals has expanded. Even when a willing seller and willing buyer have met, the time to obtain financing has been extended, especially if the SBA is involved. In addition, the due diligence process is more in-depth now as buyers are spending more time to be sure they understand what they are buying.

5. Your ultimate sale price will likely not be entirely in cash. Buyers often structure deals to include an "earn-out", which is an amount that is only paid to the seller if certain revenue or income targets are hit. There is no guarantee that the earn-out will be received so be sure that you are content with the up-front cash received from the sale.

There are a number of factors affecting merger and acquisition activity. Give us a call if you are contemplating a sale or you are just curious about the current value of your business.

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