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Trends show this may be the year to sell a business

Acquisition multiples are likely to remain at 2005 levels this year

A large number of private business owners plan to sell their companies this year. This inclination is caused by a confluence of factors: an economy that many expect to stumble in 2007; fairly good earnings in 2005, with an expectation of solid increases in 2006; an over-abundance of capital dedicated to funding acquisitions; and an increase in the number of buyers.



M&A TRENDS

Rob Slee

Acquisition multiples have been on a roller coaster since the mid-1990s. During the latter half of that decade multiples consistently increased as companies enjoyed strong growth, a rising stock market, ever-increasing profit projections, an unprecedented amount of investment capital, and bankers willing to lend as much as five to six times cash flow on larger transactions.

The fun came to a halt in the spring of 2000, as the positive macro-economic environment changed. The stock market, especially with regard to technology companies, fell dramatically. Lending tightened to the point where even solid companies could not attract capital. Finally, earnings fell for many companies as the recession gripped many segments of the U.S. economy. This backdrop continued through 2002, as selling multiples continued to fall in most categories. But the economy and the capital markets awakened in 2003. Companies began to plan again, buoyed by the prospects of better financial conditions ahead. Multiples increased in 2004 to their highest levels since 1999.

This upward trend sputtered in 2005. According to a recent International Network of M&A Partners survey, acquisition pricing for manufacturing, distribution and service companies declined 3%, 15%, and 24%, respectively, from 2004 lev-

els. IMAP surveys its members each year for completed transactions. Most of the surveyed transactions involve companies with annual sales of \$5 million to \$100 million. For 2005, there were a total of 74 transactions in the survey, with a total value of more than \$2 billion.

Acquisition multiples are expected to remain about the same in 2006, for several reasons. First, owners seem to be more interested in exiting businesses than killing deals over small pricing differences. Second, the survey contains a large number of transactions involving the acquisition or sale of companies with lower earnings in 2005 than 2006, but high strategic value. Thus, as earnings rise in 2006, even if buyer behavior remains feverish, multiples will probably stay about the same. Finally, interest rates are on the rise, which puts a damper on deal pricing.

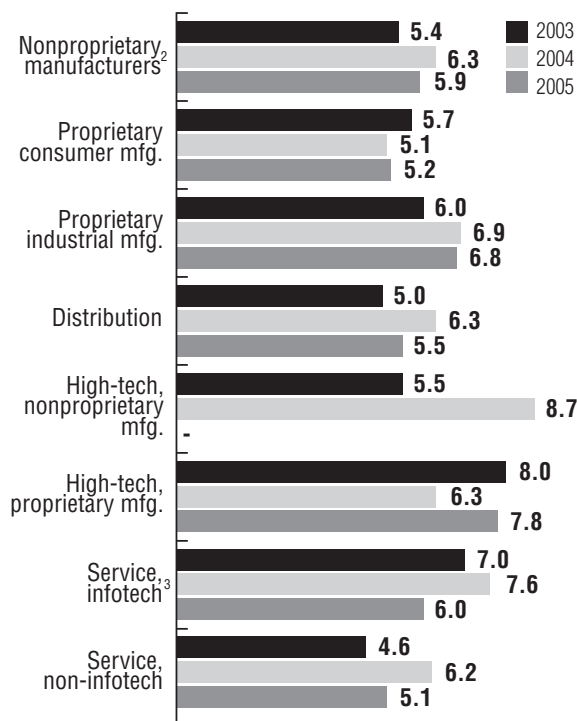
The accompanying chart shows a comparison of multiples of earnings before interest and taxes for a variety of companies during 2003-05. EBIT is calculated as trailing 12-months earnings before interest and taxes, adjusting for nonrecurring expenses and owners' discretionary expenses, together with salary in excess of fair-market rates. Seller notes, etc. are discounted to present value. To compute the multiple, one divides the purchase price plus the assumption of any interest-bearing debt by the adjusted EBIT figure.

Although not shown in the chart, there was again a positive correlation between revenue size and EBIT multiples paid. This ranged from a median 5.4 multiple for companies under \$10 million in annual revenue, to a multiple of 6.4 for companies with \$10 million to \$20 million in annual revenue, to more than eight times EBIT for companies with sales above \$50 million.

The merger-and-acquisition market is

SALES OF U.S. COMPANIES

Median multiple¹ in sale of firms with less than \$100M in revenue:



¹ Multiples used were within the middle 50% of completed transactions

² Nonproprietary companies include contract manufacturers (e.g., stampers, molders, production fabricators)

³ IT consulting, integration, software development, IT staffing. Service company transactions were not surveyed until 2003.

expected to remain strong in 2006. The amount of capital chasing private deals is at an all-time high. More than \$100 billion from private equity groups has been earmarked for investment in the private markets. Further, earnings for many private companies are increasing. Assuming the economy softens in early 2007, as many expect, now might be the time for owners to consider selling their businesses.

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