

Mergers & Acquisitions Middle Market Prospects; Methods of Selling

By Allen Gray & Gene Breslow

Contrary to many business owners' opinions, we are seeing demand for profitable company acquisitions at peak levels, especially among the U.S. and European private equity groups who are flush with cash.

These groups are so desperate for deals that some of them are offering business owners opportunities to win an all-expense vacation if they will just talk to them about selling part of their company. Other groups are being forced to return money to their investors. This acquisition "hunger" is also true among many strategic buyers in this country and Europe.

There is a real shortage of quality companies on the market now. It is estimated that the number of profitable middle market companies for sale today is down 65-75% from four years ago. This shortage is caused by the fact that many business owners are reluctant to sell now, as most of their companies are experiencing reduced profitability compared to 2000.

Multiples of cash flow being paid are typically what they were back in 1999 for most middle market companies, despite the tightened financing environment and the overall economic and world situation.

The main difference between now and the late 1990s is an owner would typically receive 80-100% cash at closing in those days. Today, an owner will typically receive 60-70% cash at closing.

Definitions

"Middle market" usually refers to privately owned companies, which can sell for a price between \$5 million and \$100 million.

"Private equity groups" are investment groups that own anywhere from a handful to more than 1,000 middle market companies. They buy controlling interest of a company, give management a minority position, provide the management with full operating control and the capital to grow and acquire, and agree to buy management out in the future at a pre-set multiple.

"Strategic buyers" are companies that have a reason to make the purchase – for example, a vendor or competitor, or a company selling different products and services to the same customer. Many potential strategic buyers are part of an equity group.

How companies are sold

For the past two decades, more than 90% of the companies with annual sales under \$100 million have sold without the use of an intermediary – either a business broker or an investment banker. On the other hand, more than 90% of the companies with annual sales over \$100 million sell with an intermediary.



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Strange, if you think about it, but true. Merger and acquisition experts have argued for years as to why this phenomenon occurs in the U.S. Many business owners say that the reason is that the intermediaries serving the smaller companies lack the professionalism and resources to justify their commission.

There are four ways a company can be sold. The results of these methods can be demonstrated with the following chart that assumes a company can be sold without an intermediary to a single interested buyer for \$10 million. In this chart the prices that can be expected for this same company using the other three methods are shown. For example, the investment banking sales process will typically result in this same company being sold for 35% more, or \$13.5 million.

This chart also shows how 45% of the possible sale situations without an intermediary typically result in the agreed-to deal terms collapsing between the letter of intent and the closing. When the investment banking sales method is used, however, the chances of a collapse decrease to 10%.

Without an Intermediary: Business owner to business owner with their attorneys and accountants assisting in the transaction. No business broker or

How Companies Are Sold	Price in Millions	% of Deals Collapsing After Letter of Intent	Number of Letters of Intent (typical)
Sales Method Without Intermediary	\$10.0	45%	1
Business Brokerage Method	\$11.0	35%	1
Advanced Business Brokerage Method	\$12.0	20%	2 to 3
Investment Banking Process	\$13.5	10%	4 to 6

investment banker is involved.

Business Brokerage Method: A price is put on the business. Broker has limited resources to research and write a selling memorandum, and to locate the best possible buyers. Financial capabilities of the broker are normally limited.

Advanced Business Brokerage Method: Similar to business brokerage method except broker is normally much more qualified and has greater research resources at his disposal to write the selling memorandum and locate the best possible buyers. No selling price is put on the company. Minimum transaction size is normally \$1 million.

Investment Banking Process: Process begins with increasing the value of a business in normally 90 days or less. Research and financial capabilities to write the selling memorandum and to locate the best possible buyers are normally excellent. Typically,

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investment bankers have strong international connections to market a company worldwide. Sale prices for this method normally start at \$5 million. The process involves selecting target buyers and having them bid three times for a company with each bid from all of the participating buyers coming at the same time. The first bid is made before the buyer visits with and talks to the seller. The number of target buyers can typically range from five to 500.

INFORMATION LINK

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