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M&A deals rise to \$5.4B in first quarter

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Colorado mergers-and-acquisitions activity remained strong in the first quarter, even as a massive global credit crunch and slowing U.S. economy cut into worldwide M&A deal value.

A total of 77 Colorado deals, worth an aggregate \$5.4 billion, closed in the first quarter of 2008, according to FactSet Mergerstat LLC, a Santa Monica, Calif.-based global provider of mergers-and-acquisitions information. That compares with 67 deals, worth a total of \$4.9 billion, that closed in the same quarter a year earlier.

In the latest quarter, price was announced in 35 percent of the deals; average deal size was just under \$200 million.

Meanwhile, global M&A volume fell 31 percent to \$661 billion in the first quarter, according to **Thomson Financial**, a subsidiary of Stamford, Conn.-based Thomson Corp., as banks reined in lending to buyout firms seeking to do the largest deals.

At the moment, the credit crunch isn't having a significant effect on smaller- and middle-market deals, said Joseph Durnford, chairman and CEO of JD Ford & Co., an investment banking firm in Denver.

"The middle market typically has not had access to, nor taken advantage of, any of the real esoteric debt structures that were used to

finance the larger deals -- no structured investment vehicles, no hedge fund financing, no collateralized debt obligations," Durnford said. "Traditionally, middle-market transactions are financed with senior commercial bank debt, maybe some mezzanine debt, but for the most part reasonably plain-vanilla debt financing."

Also, a lot of the deals currently being completed have been in the pipeline for a while, he said.

But the credit crunch ultimately may cut into the prices sellers can command, Durnford said.

"The market, in our estimate, is going to get more challenging from a pricing standpoint because there is less credit available," he said.

"There are fewer lenders willing to put money out, or they're adjusting for risk and therefore scaling back their advance rates or how much they're willing to loan. Or they're increasing their yield to compensate for their risk, which means the cost of debt is a little bit higher."

Equity investors, particularly private equity groups, typically put down cash equal to one-and-a-half to two times the target company's EBITDA (earnings before interest, taxes, depreciation and amortization), Durnford said. If they can borrow five times EBITDA on top of that, they'll pay six-and-a-half to seven times EBITDA for the company -- a purchase multiple commonly seen in recent years.

But if the amount they're able to borrow declines, they'll pay a lower multiple -- say, only four-and-a-half times EBITDA.

"It has an effect on pricing, and sellers are sometimes less willing to sell their businesses for lower purchase multiples," Durnford said. "So that becomes a tightening of the market there."

The biggest shift in the M&A market in the past six months has been the retreat of private equity buyers, who typically borrow to fund deals. Fallout from the subprime mortgage crisis has all but frozen the credit markets they rely on for financing.

But corporate strategic buyers -- or companies that buy other businesses that complement or expand their operations -- are stepping into the gap.

"America's corporations in general are in very, very good shape financially," said Phil Seefried, CEO of Headwaters, a merchant bank in Denver. "We've had a terrific run of good earnings years, cash balances are very high, and the ability of the top corporations to finance is still quite strong because of the flight to quality during this credit crisis. So they have become very effective buyers.

"On the other hand, your private equity guys are kind of stuck with processing deals they committed to last year," Seefried said. "There's no syndicated loan market at all, to speak of. So you're left with the traditional banking market and club deal market, which is generally smaller and more regionalized, and less aggressive in leverage. So you'll see smaller deals, and fewer of them."

Even if the U.S. economy went into recession, mergers-and-acquisitions activity would continue, according to John Zayac, president of Denver-based M&A advisory firm **IBG Business Services**.

"In a bad economy, some sellers just sell because they've had enough, and they don't want to ride out the economy," Zayac said. "Buyers are buying in a bad economy because they're getting a better investment and transaction value -- in other words, they're buying at the low."

But the credit crunch likely will affect even the middle-market deals, he said. Lenders already are scrutinizing deals more closely and requiring borrowers to have a higher stake in the deal, he said.

Since the fourth quarter, "buyers are definitely looking at an increase of about 5 points in their equity position, just to make the deal more fundable," he said.

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