Value Management Inc.

The Investment Banking Resource

THE M&A RESOURCE

VMI's Quarterly Investment Banking Newsletter

In This Issue

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~ 1ST QUARTER 2015 ~

Value Management Inc. ("VMI") has expanded! Known and respected since 1991 as The Business Valuation Specialist, with the 2014 addition of a full-time investment banking division, **VMI** is now also The Investment Banking Resource! **VMI**'s investment banking division is a boutique financial consulting firm focusing on selling businesses and identifying acquisition targets in the lower middle market while also providing strategic merger & acquisition consulting services. **VMI**'s investment banking professionals are experts in financial analysis who have been involved in over 100 transactions, and have worked with thousands of family-owned and other privately-held businesses, partnerships, trustees, boards of directors, and other corporate owners and advisors.

VMI is an investment banking resource that has established relationships with a comprehensive network of trusted professionals comprising and/or servicing the mergers & acquisitions community, including: private equity groups, entrepreneurs, lenders, banks, trust companies & officers, transaction lawyers, trust & estate attorneys, accountants, succession planners, wealth managers, financial planners, insurance professionals, appraisers (business valuation, real estate, machinery & equipment), auction houses, CFOs for hire, and others servicing and/or facilitating the deal-making needs of privately-owned corporate America.

In an early step towards becoming a trusted resource in the investment banking community, we are pleased to present the first edition of "The M&A Resource," **VMI**'s newsletter devoted to transaction and deal-related topics, updates and trends.

We welcome all questions relating to mergers & acquisitions and will confidentially discuss relevant issues with professionals, business owners, and/or buyers or other corporate investors. **VMI**'s purpose is to help clients and professionals identify, understand, define, engage and/or successfully negotiate clients' investment banking objectives. For professional, personal attention to your M&A needs or goals, contact Andrew Wilusz at 215.343.0500 or amw@ValueManagementInc.com.

It's A Seller's Market!

It's a good time to buy a business, which contributes to making it a great time to sell a business! (…if the business is ready, but that's another story.) Three key factors contribute to the current seller's market for businesses: the availability of funding/financing, favorable economic conditions, and the relatively large number of buyers driving demand and pushing prices higher.

A seller's market requires funding for investors to buy businesses. Investors will use some of their own money and can, in today's market, borrow a large portion of the business/investment purchase price. Interest rates and the lending environment impact the availability of funds used to finance investments. Currently, interest rates are low and there is a favorable lending environment. The cost of financing and the amount of financing available to investors (and business owners) contribute to the number of buyers willing to invest, and how much they are able and willing to pay for a business. In today's market, lenders are lending at relatively higher multiples of cash flow (generally a multiple of earnings before interest, taxes, depreciation, and amortization, or "EBITDA"). The ability to borrow at higher multiples of EBITDA enables investors to pay higher multiples for certain profitable businesses.

The economy also impacts the market for selling a business. It's obvious that a sale during a recession

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generally does not lead to the best results because many investors become overly pessimistic. On the other hand, they sometimes become overly optimistic during an economic recovery. Hence, selling during a period of an economic upturn usually means a more active marketplace and better results. Favorable economic conditions contribute to anticipated growth in revenue and earnings, more spending, a bullish stock market and investor outlook, and increased valuation multiples.

An essential aspect of the current seller's market is the relatively high number of investors in the market. Today, it includes the strategic, professional and entrepreneurial buyers. More buyers create increased demand for quality companies.

Strategic buyers can include competitors, suppliers, customers and others. They can benefit from the acquisition by reducing costs, gaining access to new markets, or adding complementary products that may easily be inserted into their distribution system. In assessing the viability of a strategic acquisition, strategic buyers include the advantages to be realized by these benefits in the potential profits, resulting in a level of profitability above the seller's historic level. The strategic buyers' perceived benefits often result in increased valuation multiples paid to the seller.

The professional investors include private equity, venture capital and angel investor groups. Private equity groups ("PEGs") have become so numerous (3,300 and growing in the U.S.) and so well-funded that they effectively and aggressively compete with strategic buyers. With a large bankroll sitting on the sidelines, PEGs actively pursue the acquisition of quality companies. Their primary aim is larger, profitable companies (generally with a minimum EBITDA of $3 million). Some may be used as "platforms" (entering an industry not currently in their portfolio) for growth, which they pursue both organically and through additional acquisitions. The additional acquisitions, which are often smaller than the platform purchases (but not necessarily), are known as "add-on" investments. The add-ons are bought to complement a company in their portfolio; in other words, PEGs are also strategic buyers. Increased competition for quality companies is a result of the proliferation of PEGs (and this is good news for sellers).

And not to be forgotten in the current seller's market are the individuals and private groups seeking the American Dream as entrepreneurs. These buyers include previous business owners who sold their business (and are looking to invest again), private investors, entrepreneurs, and wealthy families.

Current market conditions make it a seller's market. The availability of relatively inexpensive debt financing, the amount of funds raised by PEGs, and the cash on the balance sheets of buyers have increased the number of buyers in the market place. Today's economic climate adds to the confidence and optimism of these buyers. Increased demand is the end result, which makes it a great time to sell a business!

Approached by a Buyer? Say Nothing, Take Names

Business owners are frequently contacted with unsolicited offers of interest to buy their business, and in today's seller's market, buyers and their agents are more aggressively pursuing acquisition targets. Owners hear from a variety of people presenting themselves as erstwhile suitors, including: brokers looking to find businesses to sell, intermediaries paid by buyers to identify prospects, competitors wanting to buy (or to learn about the business), investors/entrepreneurs, friends/acquaintances of business and/or owners of other businesses.

Should owners ignore all the attention? What should they say to those who contact them with expressions of interest? Clearly, some (and sometimes many) of those professing an interest to buy (on their own behalf or the behalf of others) are on fishing expeditions, dropping lines indiscriminately as often and in as many places as possible. As would be expected, owners routinely ignore such generic and impersonal "offers to buy" as a waste of time - and rightfully so. But what about those calls that are or seem serious, coming from large industry players, competitors, private equity groups, friends of the business or business acquaintances? Should owners talk with those who have serious, possibly verifiable interest?

Assume that the buyer is ALWAYS working on getting the best deal. Some buyers work industry conferences trying to get an "in" with the owner. Others may spend years to become "friends" of the owner hoping to get the "first shot" when the owner is ready for sale. **VMI** has been involved in the sale of companies where such offers have been attractive and/or reasonable. However, we've seen far more where the offers have been significantly below market value and where the company has sold for over twice the price initially offered.

If you and your business are ready for a sale, it may be worth the discussion. However, unless the owner has a plan or strategy in place and has prepared for a sale, it is best to say nothing and take names. Something said can't be unsaid. Remember, any discussion that you have with a potential buyer is a form of negotiation. If you are educated and prepared for a sale, the best price is achieved by going into the market. The larger the pool of buyers considering the company, the better the opportunity to attract the best price and terms.

Market For Plastics Firms Looking Good

According to a January 2015 article from Plastics News ("It's becoming a seller's market for plastics firms"), plastics industry professionals are projecting that 2015 could be a good year for selling a plastics business. One industry expert reported a total of 341 plastics deals in 2014 (up 4 percent from 2013), while another expert tracked 431 global plastics deals in 2014 and expects more than 500 in 2015 (growth of 15 percent).

M&A activity in the automotive end market of the plastics sector saw deals more than double in 2014 (from 19 to 39). The number of deals involving companies in the industrial and the food & beverage end markets were reported to have increased by at least 10 percent in 2014. By type of process, injection molding deals had the best growth rate, increasing 10 percent in 2014 to a total of 95 deals. While down in 2014, the packaging sector continued to comprise a large part of plastics M&A activity, accounting for 29 percent of all deals. Also, there has still been much demand in the medical area, where hot consumables include syringes, fittings, valves, and implantables (hip, knee, facial).

An industry veteran stated that pricing multiples are up in general and that performance has improved for many plastics companies that have been recovering since the recession. Another M&A deal maker reported that specialty processors can exceed sale multiples of 4 to 6 times earnings before interest taxes depreciation and amortization ("EBITDA") and that he was surprised when a materials firm doing specialty work sold for 9.4 times EBITDA. "You wouldn't have seen that type of multiple last year," he said. Another expert explained that the quality of the selling firm impacts its deal price. If the average multiple is 6, a plastics firm in the top quartile of the industry might attract a 7 times multiple, while one in the top decile could receive 8 times.

Another industry market maker believes that it is the "…best M&A market since '05…the perfect storm of processors in general doing better…and corporate profits are up, so there's a lot of demand from both financial and strategic buyers." He says that 2015 "has to be year of the seller's market."

Is The Business Ready To Sell? (Part I)

There are two main considerations in determining if the business is ready to sell: the owners' decision to sell (commitment implied) and the condition of the business. (Of course, market conditions are critical… but that's another story.) Most successful sales are based on a timely decision to sell and a business which is well-prepared for the sale. Ideally, the decision to sell occurs with enough lead time to make sure that the business is optimized for sale when the conditions of both the business and the market are most conducive to realizing the highest return on the owner's investment. Rarely does this happen without planning and preparation.

For many privately-held business owners, selling the business is a "once-in-a-lifetime" event. Many family or other private owners/investors tend to make the decision to sell for reasons that are more personal than professional. Retirement, illness, and changes in life situation are common catalysts for selling the privately-owned business. Unfortunately, these events may not occur at the optimal time to sell the business.

A recent Inc. article, "4 Signs That It's Time To Sell Your Business", suggests considering both personal and professional reasoning when deciding to sell: 1) the owner no longer likes running the business and it gets them down, 2) the company's needs have outgrown the owners' capabilities, 3) the writing is on the wall in the market, and 4) there is a good deal to be made. An article from Entrepreneurs ("When Is The Right Time To Sell The Business?") offers owners the following three conditions as general indications to consider if it is the right time to sell: 1) the owner has a compelling or motivating reason to sell, 2) the owner is reasonably confident about the chances of meeting his or her objectives through the sale, and 3) the owner is psychologically prepared to relinquish ownership control.

In contrast to the above, personal events and/or considerations are rarely part of the decision to sell for professional owner(s) of privately-held businesses. Professionally-owned and managed businesses, such as those owned by private equity groups, are bought and sold as investments. Hence, the decision to sell is typically made at the end of the pre-determined investment horizon, and/or when the established growth and return benchmarks are realized (or not realized). Factors such as timing, market conditions, trends, and yield are controlling. Professional owners are always planning and preparing to buy and/or to sell because that is their job.

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It is important for most business owners (those whose job is not buying and/or selling businesses) to realize that the planning and preparation for selling a business begins with the decision to sell. A crucial starting point is identifying the professional advisors that will be on the owner's team ***if*** the owner decides to sell. Owners should select their team before or in conjunction with the decision to sell. Members of the team will draw from their professional experience to help owners understand the crucial issues, enabling them to make good decisions. This team can include: investment banker, lawyer, accountant, succession planner, tax advisor, and wealth advisor.

In the process of deciding to sell, an owner must not overlook confirming the right to sell the business. If there is a sole owner, it's a non-issue (unless it is owned in a trust or by an estate, where specific provisions may apply). If there are other shareholders or partners, the procedure for obtaining the approval to sell must be understood very early in the sale process. In some instances, action may be needed to secure the right to sell. There's nothing worse than working hard in deciding and planning to sell a business, only to be undermined in the end because authority to sell was not properly secured.

Also, if the owners are seeking a particular price, it's necessary to determine if it is a realistic expectation. Prices and valuation multiples can vary by business size, profitability, geographic location, dependencies, supply and demand factors, availability and cost of financing, competition, timing, economic factors and/or by industry. A change in any of one of these factors can impact price. If the current market value is below the owners' expectation, it may not be the right time to take it to market.

Tax implications of a sale should also be carefully considered. Many a deal has failed when the seller realized that the net proceeds were significantly different than the gross selling price. Early consideration and action is required to manage the seller's tax consequences. The same is true for managing the proceeds of the sale; the earlier the better when it comes to analyzing re-investment possibilities with a wealth planner.

Part II will be published in the next issue.

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