



**Babson College-Exit Planning Exchange
Middle-Market M&A Survey**

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In the first quarter of 2010 the MBA students at Babson College in conjunction with Professor Kevin J. Mulvaney and Exit Planning Exchange conducted a survey of over 150 leading professionals involved in middle-market mergers & acquisitions. These professionals included boutique investment banking firms specializing in middle-market companies; large business brokers; CPAs and lawyers involved in M&A and other professionals who work with buyers and sellers in M&A transactions.

The survey was augmented by telephone interviews with investment banking professionals conducted by the MBA students to allow these professionals to expand on the electronic survey input.

The objective of the 2010 survey was to build on last year's survey which was done in the depths of the economic recession. It attempted to benchmark the changes in the M&A market and project how the remaining three quarters of 2009 would unfold. This projection proved to be extremely accurate in its depiction of the middle-market M&A market for 2009.

In the 2010 survey we again attempted to benchmark the middle-market M&A industry status and asked the professionals surveyed to project the remainder of 2010. The results are summarized below in two categories- 'Corporate M&A Headlines' outlining the current and projected status and trends, and an 'Advisors' section outlining the impact of the current and projected market on the business practices of M&A professionals.



The 2010 summary should be read in conjunction with the 2009 summary to see the evolution of the market for middle-market M&A deals; the magnitude of the downturn in '09; and the beginning of the uptick in the market for deals today.

2010 Survey Headlines

-Valuations for middle-market companies have stabilized but few respondents expect any material increase in valuations for the remainder of 2010

-Deal structures continue to be challenging for buyers and sellers. Financial Buyers are struggling to get financing to support bids and Strategic Buyers are primed with large cash balances and stronger stock prices but are cautious about middle-market deals because of the uncertainty of the economy

-The deal process continues to take 6-9 months due to the challenge of more detailed due diligence and the ongoing challenge to find the most qualified buyers

-Middle-market boutique investment banking firms have seen a 3 times increase in the last four months in the number of business owners committing to put their companies on the market and report a significant increase in the number of business owners engaging in discussions with them

-Although many more financial organizations are saying they are interested in financing leveraged acquisition deals we do not see any material increase in the amount of this key financing. We will survey the financial organizations in the fall to follow up on the trends in actual loan volume. This will be important to the reemergence of Private Equity firms' and other financial buyers' deal volume

-The stability of the seller's cash flow; market share maintenance; and ability to grow revenue consistent with the industry growth rate continue to be the key ingredients to above -market valuations

-Strategic buyers (corporations) are expected to be more active as the rest of 2010 unfolds but financial buyers will continue to struggle because of the large equity percentage (30-40%) demanded by the primary lenders



FINDINGS IMPACTING BUSINESS OWNERS

-Premiums continue to be paid for healthcare, biotech, high growth technology and steady cash flow companies. 23% of the respondents project these stronger or faster-growing industries could have a 0.5-1.0 times EBITDA valuation growth by year end.

-Strategic buyers are projected to be more active in M&A as 2010 unfolds. The best thing a business owner can do is work on stabilizing cash flow and being able to document how the company is poised to benefit from the continuation of the economic recovery

-Smaller companies (\$1-10MM valuation firms) are not seeing a material uptick in the early stages of the M&A recovery. This is due to the challenge the financial buyers of those firms are having with the financing needed to complete the deal.

-Deal structures for deals under \$25MM continue to show about 20-30% of the purchase price in deferred payments (notes, earn-outs, contingent payments, etc.)

-More than 50% of the respondents cited a continued valuation gap between the perceptions of the buyers and sellers. Respondents cite this as a big concern which may impact volume as 2010 unfolds

FINDINGS IMPACTING ADVISOR BUSINESS STRATEGIES

-Only 22% of respondents, identifying themselves as advisors to business owners in M&A deals, cite concern about the future strategy of their firm. This is down from 61% in last year's survey and supports the more positive view of the direction of the M&A deal volume for 2010

-Advisors project more strategic (corporate) and foreign buyers as 2010 unfolds but don't see the reemergence of financial buyers until 2011

-73% of respondents now active in deals report currently working with service companies while 50% cite manufacturing and only 25% reported activity with distribution and retail businesses seeking exit



-32% see more debt financing available as we progress through 2010 but 50% see the current availability of debt continuing for the remainder of 2010

-60% of the advisors responding (slightly lower than the number from the 2009 survey) are frustrated by the lack of longer term planning by business owners and are concerned that this factor will increase the number of firms being forced to sell under duress in the future

OUR CONCLUSIONS

Compared with the 2009 survey which documented the volume, valuation and deal structure declines in the industry, this year's survey shows what may be the beginning of a steady turnaround in middle-market M&A volume. There has been a documented 40% reduction in the number of companies listed for sale in the past two years and this has created a backlog of companies which would normally seek some form of 'capital event' (full or partial exit by the owner or owners).

However it is incumbent on all advisors in the M&A field to engage business owners in the dialogue needed to foster proper long term exit planning. Research shows that 70% of business owners actually plan 1-2 years before a 'capital event'. With the lack of planning cited in the survey, every M&A industry advisor must do a better job getting the business owner's attention in addressing his/her longer term plan for their business.

The economy may very well have moved into the second half of the recovery cycle. If so, history reflects that larger companies and those seeking growth in market share, explore acquisitions as a vital component of their strategic plans.

For valuations to increase we need a set of factors to collide-economic growth, availability of debt funding and BOTH strategic and financial buyers active in the market. It will probably take until later this year before this condition begins to appear.