M & A activity a sign of strengthening economy

■ Local investment bankers say improved economy is leading to an uptick in deals

BY KENT DARR
kentdarr@bpcdm.com

In 2009, investment banker Steve Jacobs was trying to find a buyer for a Greater Des Moines professional services firm whose owner was ready to retire. He's still looking, but the prospects have improved this year.

Jacobs and fellow investment banker Eric Lohmeier say that if the mergers and acquisitions side of their respective businesses is any indication, the economy is on the upswing. It isn't roaring to good times, but it is headed in the right direction.

A recent report by Thomson Reuters said mergers and acquisitions worldwide are expected to exceed $3 trillion in 2011, the highest level since 2007, after an uptick this year.

International calm, local caution

Jacobs is president of BCC Advisers, a Des Moines company that specializes in mergers and acquisitions, corporate finance and business valuations. Last year, when he was hoping to ease a business owner into retirement, activity in BCC Advisers' mergers and acquisitions segment was slow, to be generous.

The problem for Jacobs' client, whom he would not identify for confidentiality reasons, was that in 2009, likely buyers were hoarding capital, trimming assets or otherwise attempting to survive the weak economy.

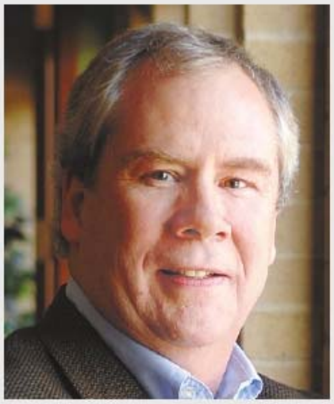
"In 2009, we tested the waters and presented to qualified out-of-market buyers," Jacobs said. "There was little interest. We met with one party a second time, but they passed because of uncertainty about the economy."

Jacobs took the company off the market, then tried the same buyer pool in July.

"Now, we have three interested parties out of that same group," he said. "They feel better about the economy and their organizations. There's a lot more certainty about the future success of their business."

That prevailing sense of calm was evident last month when Jacobs attended a conference in Paris conducted by IMAP Inc., an international organization of merger and acquisition specialists.

"The mood was considerably different than last year," Jacobs said. "It was much more positive and upbeat. … The markets have settled down, and companies that survived the downturn are sustainable. That gives buyers more information to make decisions. There is less uncertainty, and that makes for a better environment for buyers and sellers.



STEVE JACOBS
BCC Advisers

"The markets have settled down, and companies that survived the downturn are sustainable. That gives buyers more information to make decisions. There is less uncertainty, and that makes for a better environment for buyers and sellers."

ERIC LOHMEIER
NCP Inc.

"In commercial and industrial loans, banks are waking up and saying, 'We're back to business,' so mid-size businesses are having some access to capital. They can reinvest in operations, and their best way to grow is to buy smaller businesses."

Focus Story

"Many businesses had a very poor 2008 and 2009, but they were able to downsize and improve the value of their businesses. When you do that, companies have more confidence in the businesses that have survived."

Jacobs noted that companies looking for acquisitions in 2009 and earlier this year often were engaged in "bottom feeding" on businesses that could be bought on the cheap.

"What we are seeing now is that buyers are willing to pay a fair price based on value for the current year but also based on what they see going into the future," he said.

The money to make a purchase isn't always easy to come by. Although national lenders have reentered the market, many regional and local banks lack the capital resources to take a chance on financing an acquisition, which is always risky regardless of the health of the economy.

"There isn't any question that an era of much less risk taking (by lenders) has begun," Jacobs said.

Some companies are going to have to look beyond traditional lenders to finance their activities.

"Over the last four years, there was a reasonable amount of funding available, but in terms of coming up with higher levels, whether subordinated or equity, small and medium-sized businesses are going to have to get more creative," Jacobs said. "They are going to have to turn to family, friends and angel investors for the capital to build and grow their business, either through acquisitions or through organic growth."

In some cases, sellers will carry some of the financing necessary for buyers to obtain senior bank financing, he said.

"There are community banks out there who are very eager to lend," Jacobs said. "The issue is who are they willing to lend to. Some just can't borrow money. Banks just aren't in a position to lend equity capital. They took so much risk (leading up to the collapse in the financial markets) that they effectively became equity lenders. That was a pretty expensive lesson."

Double the volume

In 2008, Eric Lohmeier thought his company, NCP Inc., had hit its stride in mergers and acquisitions. That year, the investment banking firm wrapped up three deals valued at more than $100 million.The segment accounted for about 60 percent of NCP's business. The young company had found its sweet spot.

Then 2009 rolled around, and NCP struggled to hold its own financially.

"We didn't lose money. That was the big win," Lohmeier said.

The sweet spot had turned sour that year. A conversation with Lohmeier typically involves a cruise down recent memory lane and touches on the collapse of the credit markets and the necessary government intervention to resurrect them – focused primarily on the "too big to fail" banks.

Government intervention "reset the entire world economy" and started the ball rolling, Lohmeier said. The last six months saw the large national lenders willing to re-enter the mergers and acquisitions market, with well-capitalized regional and local lenders eager to follow, he said.

"In commercial and industrial loans, banks are waking up and saying, 'We're back to business,' so mid-size businesses are having some access to capital," Lohmeier said. "They can reinvest in operations, and their best way to grow is to buy smaller businesses."

This year, NCP has seen its volume of merger and acquisition deals grow to between 15 and 20. Next year looks promising, too.

Lohmeier agrees with Jacobs that it remains difficult for smaller businesses, those with a net worth of $2 million to $5 million, to find capital.

"All they've had for years is a relationship with their two or three banks," he said. "Now, maybe two of those relationships have gone sour."

For those companies, the only way to a better future might be to agree to merge or be acquired by a larger, healthier company, Lohmeier said. It's all part of what he calls the bifurcation in the economy, where large, well-capitalized businesses can acquire weaker companies that are struggling to extend credit lines and expand operations. ❐