

MAKING SENSE of it ALL



How small to mid-sized companies can protect and preserve their values in these volatile economic times. **By Lance Tullius**

Admit it. You've never seen anything like it in your life. Seemingly overnight, home foreclosures skyrocketed, values plummeted and primary and secondary lenders were left with paper they simply could not collect on. The broader markets didn't know how to respond, resulting in stock market swings not easy to stomach for institutional investors, let alone individuals.

Amidst this, and on the heels a fairly strong economy for the past several years, the baby boom generation is closing in on its retirement years, with many owning small to mid-size businesses that are being banked upon to fund retirement years. So

what does the convergence of these respective forces mean for small and mid-market businesses, specifically with respect to the market value of these businesses?

Nearly all of us are asking what this recent phenomena really means, and while most all of us have an opinion, nobody knows for sure. What we can assess, however, is what it has meant to date and given that, what it's likely to signal for the future.

HOUSING MARKET BLUES. Most agree that the root cause to all this chaos was the residential real estate market. Demand for housing rose in most major markets through-

out the late 1990s and the early part of this decade; prices rose accordingly, making it more difficult for first-time buyers to get in the market. Lenders got very aggressive, providing sub-prime loans that in hindsight should have never been made, at least not to the extent that they were made. Eyebrows were raised by the fundamentals, or lack thereof, to this market, but lenders in particular turned the other cheek, many of whom have packaged and sold those loans to the secondary market.

The strength and duration of the ultra-strong housing market led many to believe that there was no end in sight. However, as with every other market extreme in our history, a correction awaited, and as we now know, that correction broadsided most of us when it hit the surface last summer.

The first tremor was a slow but consistent decline in housing prices. Suddenly, in some instances, houses couldn't sell for even the value of the mortgage on them, leaving lenders to write off loans. A chain reaction began that took on relatively mas-

While valuations of these small and mid-sized companies have not risen in the last year, we've certainly not seen a decline. Not yet, anyway. This is due to a combination of circumstances.

First, despite the recession-like characteristics of the present economy, there remains massive liquidity across the markets. Much of that liquidity is still being targeted for deployment, and among the best means of putting liquidity to work is through business acquisition.

In addition, while the secondary lending markets have virtually shut down, the primary markets, particularly when it comes to deals involving small to mid-sized businesses, are still quite active. Senior debt remains very much accessible for acquisitions of these businesses. So long as acquirers can put decent amounts of leverage on their transactions, there probably won't be significant declines in market valuations.

Furthermore, with the dollar so weak versus other currencies, the environment for acquiring U.S. businesses is arguably

sheer volume of companies that will be available to be acquired.

The seller's market that we've experienced for the last several years will accordingly transition to a buyer's market. Businesses will certainly be salable, but it will take more effort and a higher quality business to get noticed by the right buyers, and subsequently to get those buyers to pay a premium price for the business.

Will the economy have an impact on merger and acquisition activity for the small and mid-sized business owner? Certainly. However, it is hard to imagine that the impact will be less activity and fewer deals. In rough economies it becomes more difficult to achieve organic growth, prompting many companies to view acquisitions as the major source to perpetuate growth. The small to mid-sized business segment will always be a staple upon which larger companies view growth and expansion opportunities. It's simply the dynamics that will change.

MAKE A PLAN. So what can small to mid-sized business owners do to protect and preserve the value of their business in what will assuredly become a more challenging environment for capturing and recognizing that value? As simple and mundane as it sounds, they must have a plan. And that plan has to be built around and culminate with an exit strategy.

Business owners in this category must seek to understand exactly every metric that drives value in their specific business or industry, and understand how and why it drives value. They must then make it a priority to become best in class with respect to each of those metrics that most impact the value of their business. And they must wrap their plan up with an exit strategy that offers some flexibility, but addresses such aspects as timing for an exit and what type of exit will be most suitable (e.g., sale, management buyout, family succession, ESOP, etc.); and if a sale, what types of buyers will be most likely to pay a premium price for the business, and what valuation they might expect in return for the efforts they have put forth in the business.

No matter which vantage point from which you view this unprecedented economy, challenges are and will continue to face us all. As with everything in life, those who rise to the challenge will win. 🐛

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sive proportions. As with all early stages to a "correction," panic unfortunately plays a significant role in how deep and how long the correction will last. To this point, the credit markets virtually shut down in late summer and early fall 2007.

M&A UPDATE. As far as businesses go, numerous merger and acquisition (M&A) deals "went south," mostly as a result of dried-up or more costly funding. Most of these transactions, though, involved large public companies rather than those in the small to mid-size market. While merger and acquisition activity has slowed across the board, it remains relatively high when viewed in a historic light. Why is this and what might the future hold?

What is particularly fascinating about our current economic markets is the level to which they are fluctuating and, perhaps more amazing, the polarizing nature of these markets. For instance, while many publicized larger transactions have been tabled within the last nine months, the market for transactions involving the acquisition of small to mid-sized businesses hasn't missed a beat, and in some respects could be considered frenzied.

better than ever before, leading large companies from all over the world to continue acquiring U.S. companies.

Finally, the uncertainty coinciding with the current economy coupled with Baby boomer business owners preparing for retirement, has fueled an active and on-going pipeline of companies desiring to sell.

LOOKING AHEAD. So what can we expect moving forward? It's unlikely that we will see merger and acquisition activity among the small to mid-size business sector decline anytime soon. In fact, multiple merger and acquisition-based publications have reported within the last year that it is anticipated that seven out of every 10 small to mid-sized businesses will transfer ownership within the next ten years, a staggering statistic.

Most point to the Baby boomer phenomenon as the single greatest factor expected to drive this movement. And this movement has already commenced. This doesn't mean that valuations of companies in this sector will rise, however. To the contrary, valuations will most certainly experience declines in the coming months and years, if for no other reason than the