



May/June 2011 Volume 31 • Number 3

SERVICES

The Official Magazine for the Building Service Contracting Industry and the BSCAI

THE GREEN REPORT



ARE THE MARKETS
BACK OR NOT?

Business Mistakes
to Avoid



Are the Markets Back OR NOT?

By Lance Tulus

Confusion and ambiguity reign supreme in assessing current state of M&A markets.

So are the markets really back? As can be imagined, this is amongst the most frequently debated topics in times like these. The root questions at issue for most BSCs are twofold: one, are buyers buying again? And, two; are buyers paying higher prices for companies? So, let's dive into what's really going on.

It should first be acknowledged that due to certain core fundamentals of the building service industry, notably its history of relatively stable performance in recessionary climates, merger and acquisition activity never exactly fell off the cliff that it did in many industries. Even during the depths of the recent recession, BSCs were being purchased and sold, albeit with less frequency than in prior times. This was in stark contrast to that evidenced in many other industries: that being a near complete freeze on any type of deal activity. Early in 2010, however, signs began to suggest that a turn was on the horizon across almost all industries, including the building service sector. First, large corporations were hoarding unprecedented levels of cash on their balance sheets; a result of slightly rebounding revenues and dramatic cost cuts that preceded the rebound. Adding to this liquidity surplus, the credit markets were beginning to loosen up, providing added capital access to all types of potential business buyers. And finally, because corporate revenues were only rebounding slightly, there appeared to be an impetus for generating

growth through acquisitions. Keep in mind that due to their capitalization structure, large corporations are under constant pressure to grow revenues and earnings. This is among the key drivers motivating acquisitions across all industries.

Also leading to this acceleration in merger and acquisition activity were trends taking shape in the private equity sector. Private equity groups, as they're commonly referred to, are entities that effectively serve as vehicles for large sums of capital to be deployed into what are generally mid-sized privately held businesses. Amongst their various functions, private equity groups seek to raise "funds" from both private and institutional investors. Then, through an entity that consists mostly of managing partners, analysts and support personnel, these firms seek out compelling investment opportunities in mostly the private sector. Unlike traditionally thought-of investors, these investment firms generally don't get involved in the actual operations of the businesses they invest in. Rather, their objective is to identify businesses with seasoned, capable management already in place, and then acquire and/or invest in that business and back it with capital used to fund future growth. As these types of investment firms became increasingly in vogue throughout the 1980s and 90s, their focus was overwhelmingly on such high-growth sectors as high technology, Internet, and health care. However, subsequent to the dot-com fallout at the turn of the century, and then more so

as we proceeded through the first decade of the new century, these firms turned their attention in a big way towards lower tech and in many ways less exciting industries such as the building service space. While these industries didn't necessarily offer the home run potential of other more growth-oriented sectors, that attribute was offset by much greater predictability within these businesses, which substantially lessened the risk incurred by these investment types. Having been humbled by multiple and recent economic downturns, risk mitigation was becoming a sought-after characteristic of investors of all types. Within the last five years alone, there have been more than a handful of private equity firms that have invested in the building service industry. There are many more still looking to enter the space. The BSCs they have invested in are now amongst some of the more active acquirers in the industry. As a category, private equity firms alone are sitting on a reported \$400- to \$500-billion of committed but uninvested capital right now. And, like their corporate brethren, on top of this pent-up capital, they've now got better access to debt capital than they've had since before the recession. Accordingly, it's quite easy to see how many of the building service industry's acquirers are and will continue to come from this segment of the overall investment population.

Coinciding with these developments, it can be said with sound support that, yes, buyers are, in fact, buying again. Not only that, but there are probably more legitimately capitalized buyers in this market that are prepared to buy now than there are good, soundly producing companies ready to contemplate selling. Naturally then, these buyers must be paying or are willing to pay higher prices for the

companies they intend to acquire, right? Not so fast. Understanding that the process that yields "fair market value" for a business is never a science, by and large we've not seen notable major shifts in the pricing of businesses since the depths of the recession. Yes, we've seen pricing go up some, but not to the noticeable extent that many might have expected coming out of the worst recession this country has experienced since the Great Depression. So, why not?

First, as with the question of whether buyers are buying again, we must view this one within the context of historic merger and acquisition activity within the building service industry. For all of us that benefit from this industry, it should not go unnoticed just how much the industry's relative stability plays to our favor. That stability does create challenges, as in a quite competitive market place; yet it also tends to cushion the blows that external events—such as a global recession—inevitably create. Thus, while hundreds of thousands of businesses in various industries throughout the world saw the liquidity markets for their businesses reduced to near nothing, BSCs, even at the lowest points of the recession, still had a liquid market through which to sell their business in relatively quick order. Naturally, a by-product of this is that when the global markets return to more normal levels of activity, the building service industry will continue to find itself within a relatively narrow range of stability. Making the analogy to merger and acquisition activity, where there is a shorter distance to fall, there also is generally lesser upside by which to rise.

Another reason for the still somewhat cautious approach to valuing BSCs in this current market relates to an effect being experienced across almost all industries. That is, while it does seem clear that the economy has made meaningful improvement, there remains much concern and uncertainty within the markets. Amidst all the positive economic movements over the last 18 months, the unemployment rate, a very key measure of economic vitality, remains relatively unchanged. Furthermore, our world has experienced an unusual amount of disasters, both manmade and natural, within the past several years, the impact of which has yet to be totally realized. Accordingly, corporate and financial investors still remain quite protective, understandably so. For all of these reasons, we've generally not seen a major rise in pricing of acquisitions and likely won't anytime soon.

In the aftermath of all that has impacted our economy within the past several years, the current environment for mergers and acquisitions and business valuations has to be considered a good one. Those BSCs that look to be opportunistic amidst this window of activity will put themselves in the best position to benefit from it. Those that don't will do so at their own peril. Because, while nobody can predict the future with certainty, it's safe to say that amidst the uncertainty, the industry will continue to evolve whether you do or not.

Lance R. Tullius is managing partner of Tullius Partners, an investment banking firm that specializes in providing merger and acquisition and financial/strategic advisory services to companies in the building service contracting industry. He can be reached at lance@tullius.com.



ADVANTAGE VACUUM



- Wholesale Commercial Distributor for Vacuum Parts & Supplies Since 1989
- Offering low prices, fast delivery, excellent product knowledge and superior customer support

PROTEAM SUPERCOACH HEPA
CRI Certified Gold
Meets LEED Requirements

Alan Schwartz
Advantage Vacuum Company
273 East Inman Avenue, Suite B
Rahway, NJ 07065
(877)777-6383 • (732)381-9555
Fax (732)381-9559
advacnj@aol.com
www.advacnj.com