

Links Capital Partners is an independent corporate finance firm focused on providing advice on acquisitions, divestitures and financings to middle-market businesses



February 2010

**ACQUISITIONS
DIVESTITURES
FINANCINGS**

Links Capital's M&A Perspectives

Since the writing of the last newsletter the equity markets have been range bound with the concern that there may be another pull back on the horizon. Others argue for a "V" shaped recovery. This uncertainty does not lend well to those companies whose owners are looking at a divestiture or financing event. The last thing that one needs is a continued unstable environment.

Oil prices edged up into the low \$80 range and then pulled back sharply. As the economic recovery is going to be one of the main driving forces for oil prices, it is difficult to find strong consistent evidence that the recovery is actually going to occur in a straight line and we are not going into a double dip. Natural gas prices have strengthened since our last report and are almost double what they were in September and forward prices look to be significantly higher for next winter which bodes well for all markets that are leveraged to natural gas.

Until the global economy starts gearing up and there is confidence that it is not going backwards, divestitures should be only contemplated in niche markets. There have been some notable transactions closed in the infrastructure as well as the technology space. Without contracts in hand or confirmed orders, it is difficult to substantiate forecasts which adds greater uncertainty to a company's forecast.

The Impact of Leverage Ratios on Transactions

Valuation multiples have contracted as leverage available to prospective purchasers still remains tight. In the current market we are seeing senior debt levels on average, in the range of 3.00-3.50 times EBITDA compared to 24 months ago when levels were near 5.00-5.50 times EBITDA for the same middle market company. This means that acquiring purchasers will have to rely on raising more equity or look towards the vendor to provide vendor financing.

Purchase Price	60,500,000	60,500,000
EBITDA	11,000,000	11,000,000
Operating Line	15,000,000	15,000,000
Long Term Debt	40,000,000	20,750,000
Total Senior Debt	55,000,000	35,750,000
Leverage Multiple	5.00x	3.25x
Equity and/or Vendor Note Required	5,500,000	24,750,000

In the above table, the change that we have experienced in the leverage multiple results in an increased equity and/or vendor note of \$19.25 million or 32% of the transaction value, assuming no change in purchase price. If the acquisition is going to be funded by an increase in equity, it is unlikely that the vendor is going to get the same purchase price multiple. However, should the vendor be prepared to bridge the \$19.25 million gap with vendor financing there could be an argument made that the purchase price should not change all other things being equal.

Experience in the areas of Private Equity, Investment Banking, Valuations and Corporate Lending enhances value to our clients.

Our diversified financial background combines various ideologies in positioning our clients to maximize value in their business, whether it is the sale of a business, bringing on a financial partner, or attracting additional capital, Links Capital can help.

Links Capital's philosophy is to preserve value throughout the entire transaction process. Only senior executives will handle all aspects of the transaction from inception to close, avoiding potential value loss by not having less experienced junior analysts involved in the transaction.

Typical transactions range in size up to \$250 million which are ideally suited to middle-market businesses. Links Capital's management has been successful managing capital on behalf of government, provincial pension funds, insurance companies and high net worth investors in completing mergers, acquisitions, divestitures and financings for both private and public companies.



Links Capital

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At Links Capital Partners, we focus exclusively on assisting our clients sell, buy and finance businesses.



In reality what is occurring in most instances is a reluctance to pay the same purchase price multiple as the ability to add increased leverage is more restricted. This is not good news to those interested in divesting their company. As noted previously the vendor can bridge some of the financing gap but the purchasers are becoming more concerned with cash flow stability and do not want to be over leveraged putting the financial health of the company and/or the vendor's debt investment at risk.

How long will these leverage multiples stay in the range that they are in currently and how leveraged do acquiring companies want to be with uncertainty surrounding them? Looking back historically, it looks like things have reverted back to the mean. This doesn't mean that multiples will not expand in the future, but for the near term future, the current environment is likely going to be reality for some time until something changes fundamentally.

Where should the focus be now?

For those companies that are looking at a potential divestiture event, our stance has not changed over the last eighteen months. We have been advising most of our clients to focus more on their internal controls/processes and to start working more aggressively on developing another layer of management who can run the business independent of the ownership group. Succession is key!

Having a strong management team that will remain with the company subsequent to an acquisition is an asset for those owners looking to divest of the business allowing them to step away almost immediately at the close. For those who are very deeply entrenched in the business, they are almost always asked to stay on for some period of time to either run the business or work with through the transition of the business delaying their ultimate exit. Getting the right management team in place and having them run the business without the day-to-day oversight of the ownership group will help mitigate these continuity and transition issues.

How is 2010 Shaping Up?

2010 is likely going to be another interesting year for financings, acquisitions and divestitures. We expect that acquisition activity will increase as the economy stabilizes but the question remains when will it happen? However, we feel there will continue to be opportunities in niche industries where growth is being experienced.

Private equity groups were hit hard over the past two years and with the recovery of the stock market in the second half of 2009, it helped position some of these funds to exit investments as valuations for their investee companies increased. According to Pitchbook, in the month of January 2010 private equity exits were up over 130% year over year and further deal flow seemed to be picking up overall.

Private equity funds continue to have an overhang of committed capital as many transactions have not closed over the last couple of years. It is only a matter of time before some of that committed capital starts entering the market in a big way. With valuations still attractive in many industries we are now beginning to see more interest by private equity groups.

However, through the month of January till the writing of this newsletter it seems that the M&A activity has paused once again. Without strong conviction about the direction of the economy on the part of CEOs and Presidents of these potential acquiring companies, deals are not going to get done.

Your decision to undertake a business transaction is a major business decision, that's why we've committed ourselves to overcoming the obstacles you would typically face - **creating incremental value and making the process less disruptive to your business.**

Links Capital Partners is a professional firm focused exclusively on **Selling Businesses, Raising Capital** and assisting our clients **Acquire Businesses.**

