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High valuations, credit markets friendly to deals

Jeremy Siegfried *Porter Wright Morris & Arthur LLP*

An uptick in mergers and acquisitions is being helped along by favorable credit markets and valuations, and there are more companies with cash to spend, said Jeremy Siegfried, a partner at Porter Wright Morris & Arthur LLP who represents buyers and sellers in all aspects of business transactions.

He enjoys the excitement of facilitating mergers and acquisitions – even if about half of deals fall through.

When we talked earlier this month, Siegfried said he anticipates the oil and gas boom in Ohio and increases in banking regulations will continue to drive mergers and acquisitions in those industries. An edited transcript of our conversation:

-Melissa Kossler Dutton

JANET ADAMS

What are the biggest factors helping deals right now? There are a number of things going on right now. First of all, a lot of companies have a significant amount of cash on hand. The question is what do you do with that money? How do you maximize returns for your shareholders? You can do things like pay dividends, buy back your stock, or you can look at acquisitions as a way to put that money to work. M&A deals spur growth for that company looking at earnings. One way to drive earnings growth is through acquisitions. Mature companies often don't have that accelerated growth and look to achieve that growth and other synergies by going out and buying another company. Private equity also is playing a large role domestically. They have a lot of dry powder and their funds have limited lifespans. If they don't spend it, they have to return it to investors. They are looking for ways to invest that money in new portfolio companies or to grow their current portfolio companies by pursuing "bolt-on" acquisitions. The credit markets are also favorable to lenders – couple this with the low interest rate environment – those are additional tailwinds helping deal activity. Also, valuations are pretty good right now. If you want to sell a business, multiples for your company may be at the highest they have been over the last couple years.

What are the biggest factors hindering them right now? 2013 started out sluggish. The second half was a lot busier and 2014 continues to be a lot stronger. Some of the headwinds seen in the past were a result of economic or political uncertainty. Those are the types of things that can really cool off mergers and acquisitions. The flip side of valuations being so high is that if you are looking to acquire a business, you have to be careful about overpaying.

Experts estimate that about half of merger and acquisition deals fall through. Does that seem accurate to you? It's hard to say. But that's probably a fair assessment. Looking at my work in the last two or three months, I closed a deal on June 30. Before that, I had one that fell apart. In the last month, I've had one deal that closed and one that won't. Deals are exciting because they are all different. It's not so exciting when deals fall apart. You can put a lot of work into one, and for whatever reason, the deal falls apart. It's a little bit of letdown for everybody, but sometimes it's for the best. Deals can fail for a variety of reasons. If the buyer, in the course of doing due diligence, uncovers some kind of surprise – a tax liability, environmental liability, or issues with intellectual property ownership – that can create a problem, as can deteriorating financial conditions or unexpected events such as the loss of a major customer. I try to stress, especially with sellers – you want to keep these transactions very confidential. If information gets out there in the public, it can destroy value or create a loss of confidence.

Speaking of deals that fall apart, we bet you have developed an intuition about them. What are the signs that lead you to believe a deal might be in jeopardy? If you're on the sell side, the biggest tell is the sound of silence. If the buyer starts acting lethargic or becomes disengaged from the process. That's one of the things I get nervous about – when a buyer goes from very engaged to not very engaged. That's one of the earliest tells. I start to wonder what's going on if the buyer is not responsive. On the buy side, one of the signs you have a problem is when something turns up in the due diligence and the seller doesn't understand the full scope of what you found. It may not be a deal killer, but may cause (buyers) to think about how much they will pay for the company.

What do you see happening in the M&A landscape in the next few years? I don't see any reason why the good environment won't continue in the near term. The mid-term elections or presidential election could cause the uncertainty factor to come creeping back. Any pullback in the stock market that is at a correction level would also have the effect of cooling off deal activity. Today, there's lot of cross-border M&A activity. We live in a global world. Foreign investors and companies may view coming into the U.S. as an attractive way to spend their capital. American companies may be asking, "Have we saturated the market in the U.S.? Is there a way we can grow overseas?" A lot of baby boomers who own closely held family business are trying to decide what to do with their businesses as they near retirement. Some have children or other family members in the next generation down to pass the business. Others may be looking to sell or find some other exit as they reach retirement age. I have seen this a lot during the last several years, and I expect this trend to continue.

Are there any industries in which you expect to see more M&A activity? Energy is hot. There's a lot of news here in our state ... with oil and gas and fracking. There's a lot of M&A activity going on that trickles down through that whole supply chain in that industry. Heath care is probably another (hot M&A) industry. Technology is still active. Smaller community banks – we've been seeing a lot of M&A activity with those as well. A lot of these smaller banks are looking at business combinations as a way to be in a position to better manage the regulatory burdens that have come about in the last few years.