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Private acquisition multiples are beginning to rise

Acquisition prices for private companies with sales of less than \$100 million are on the rise relative to the past several years.

Acquisition multiples have been on a roller coaster for the past 10 years. During the latter half of the 1990s, multiples consistently increased as companies enjoyed strong growth, a rising stock market, ever-increasing profit projections, an unprecedented amount of investment capital and bankers willing to lend as much as four times cash flow on larger transactions.



**M&A
 TRENDS**

**Rob
 Slee**

The fun came to a halt in the spring of 2000, as the positive macro-economic environment changed. The stock market, especially with regard to technology companies, fell dramatically. Lending tightened to the point where even solid companies could not attract capital. Finally, earnings fell for many companies as the recession gripped many segments of the U.S. economy beginning in the fall of 2000. The trend continued through 2002, as selling multiples fell in most categories.

The economy and the capital markets awakened in 2003. Companies began to plan again, buoyed by the prospects of better financial conditions ahead. Although public stock prices do not correlate with acquisition prices in the lower-middle market, nearly everyone feels better when the public markets go up. This generally leads to increased merger and acquisition activity, and eventually to increased selling multiples. This is what happened in 2003, and it has continued into this year.

The transactional data presented here comes from the International Network of M&A Partners, an organization of investment bankers specializing in the sale of middle-market companies. IMAP sur-

veys its members each year for completed transactions. For 2003, there were a total of 98 transactions in the survey, with a total value of about \$2 billion.

The table shows a comparison of multiples of earnings before interest and taxes paid for a variety of companies during 2001-03. EBIT itself must be defined for meaningful comparison. EBIT is calculated as trailing 12-months earnings before interest and taxes, adjusting for nonrecurrent expenses and owners' discretionary expenses, together with salary in excess of fair market rates. Seller notes, etc. are discounted to present value. To compute the multiple, one simply divides the purchase price plus the assumption of any interest-bearing debt by the adjusted EBIT figure.

As is normally the case, the 2003 multiples demonstrate a positive correlation between revenue size and EBIT multiples paid. Selling multiples jumped in 2003, especially in the larger company categories. Multiples for companies with annual revenue above \$20 million increased by about 30% from 2002 levels.

Multiples are typically highest for proprietary companies, which reflects the market's willingness to pay more for niche-oriented businesses. That was the case in 2003. Proprietary consumer company multiples were greater than nonproprietary deals; likewise, high-tech proprietary companies sold for dramatically higher multiples than their counterparts.

Although not itemized on the multiples chart, IMAP began surveying two new types of company multiples in 2003: service/information technology, such as IT consulting, software development, IT staffing, etc., and service/non-information technology. Those multiples were 7.0 and 4.6, respectively.

Several observations can be made from the survey. First, the average equity percentage employed by buyers in the surveyed transactions was 43%, which is slightly higher than the prior three years. Second, the survey reported 30% more buyers in 2003 than in 2002, and about the

SALES OF COMPANIES

	Median multiple ¹		
By revenue:	2001	2002	2003
\$50 million-\$100 million	5.7	5.0	6.4
\$20 million-\$50 million	5.5	4.8	6.5
\$10 million-\$20 million	5.1	5.5	5.8
\$3 million-\$10 million	5.0	5.1	4.8
By product or type:			
Nonproprietary²	4.5	4.7	5.4
Proprietary consumer	5.9	5.6	5.7
Proprietary industrial	5.7	5.3	6.0
Distribution	4.6	4.8	5.0
High-tech, nonproprietary	4.1	7.2	5.5
High-tech, proprietary	9.0	4.4	8.0

¹ Multiples used were within the middle 50% of completed transactions

² Nonproprietary companies include contract manufacturers (e.g., stampers, molders, production fabricators).

same number of sellers for the same year-to-year comparison. That suggests deal inflation, which largely explains the increases in multiples. Most of the IMAP members responded that it remained difficult to access bank financing in 2003 but that this was expected to improve in 2004.

This past year signaled a change in the private acquisitions market. After a three-year hiatus, acquisitions are occurring again at reasonable multiples. Because of the vast amounts of capital available from banks and private equity firms to support such deals, most investment bankers expect M&A activity to increase over the next few years.

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