



## **Babson College- Exit Planning Exchange Middle-Market M&A Survey**

*Professor Kevin J. Mulvaney  
kmulvaney@babson.edu  
617-519-1758*

Between February, 2009 and early March, 2009, graduate students at the Olin School of Business at Babson College, Wellesley, MA in conjunction with Exit Planning Exchange ([exitplanningexchange.com](http://exitplanningexchange.com)), conducted a survey of over 100 professional advisors involved with middle-market companies (companies valued between \$5-100MM). The survey was conducted under the guidance of Professor Kevin J. Mulvaney of Babson College. The electronic survey was augmented by a set of telephone interviews with leading regional investment banking firms to ascertain the trends and condition of the M&A markets. The results of both the survey and the interviews are included in the summary below.

The objective of the survey was to benchmark the trends in middle-market deals over the past six months but more importantly to gain input from a large set of professionals who deal with business owners on the trends they project the remainder of 2009. This period of economic deterioration has reduced the volume and changed the structure of middle-market deals very significantly.

We hope this survey gives readers data on the marketplace in M&A; provides input as professional firms rethink their strategies in light of economic uncertainty; and adds value to the primary mission of all involved- assisting business owners as they debate and pursue exit strategies for their companies.

The format of the report is a consolidation of survey and interview input and is classified by Business Owner, Intermediaries (Investment Bankers and Business Brokers), and Advisors to Business Owners (CPAs, Lawyers, Tax Professionals, Financial Advisors, Consultants, Exit Planning Professionals). We have augmented the report with a set of observations and recommendations we hope assist firms in their strategic and operational effectiveness.

### **Business Owner Results:**                    (*% shown= respondents to survey*)

The survey was clear and overwhelming that the market for M&A deals in the middle-market has changed significantly. In addition, business owners are torn between the reality that multiples of EBITDA for their businesses have reduced and may reduce further, and the daunting challenges of delivering performance and positive cash flow in this economic period.

- Multiples of EBITDA for healthcare, some technology companies and companies performing well in higher growth industries have not dropped and are not expected to change materially in 2009.
- Multiples for most other performing companies (positive EBITDA/cash flow) have dropped 0.5-1.5 times (55%) from mid- 2008 to March, 2009. These multiples are



expected to see further deterioration of another 0.5-1.0 times EBITDA in the remainder of 2009 (60%).

- PE firms are primarily looking at rollups to build portfolio companies and distressed asset situations and are not currently active buyers of middle-market companies. Fewer financial buyers will be in the market in the remainder of 2009 (76%).
- Strategic (corporate) buyers are still nibbling around deals but are dropping out of deals later in the deal process than in the past, and this is causing significant frustration for intermediaries and business owners (35%). Causes are perceived to be internal strategic debates and a drop in the value of the currencies used for M&A deals (stock and cash). Fewer strategic deals are expected to be done in rest of 2009 (35%).
- Timeframe to complete deals has lengthened by about 3 months (67%).
- The percentage of 'Seller Assistance' (seller notes, earn outs, etc) in a deal has increased from an average of 10% of purchase price to 20-30% of purchase price (65%).
- 41% of respondents see business owners doing more planning for exits but majority of respondents see no change in current environment.
- Most respondents (in their survey comments) see business owner frustration at an all-time high- Who are the real buyers? Should I commit to build the business to the next level or sell now? Will the market and my valuation come back? How do I balance running my business and also planning for exit?

## **RECOMMENDATIONS**

- Business owners need to know the context of EBITDA multiples versus historical trends and averages. In a ten year context the current multiples are at the average but have dropped from the highs of the past years. Business owners cannot 'time' the market. They must plan for exit in an orderly way and without waiting until a crisis forces sale of the company.
- Communicate to business owners WHO are the REAL BUYERS, and how these potential buyers will operate in today's market.
- Information sells companies! Thus the quality and preparation of the company and the clear and thorough explanations of cash flow and industry trends is even more important in this environment to potential buyers.



### **Intermediary Results:**

(Investment Bankers and Business Brokers- survey and telephone results)

- Intermediaries are slightly more optimistic about M&A deal volume in the second half of 2009 versus other Advisors surveyed.
- Vast majority see Industry Focus as key to their business strategy in the future and are taking action now to improve their knowledge and effectiveness in this area. Actions cited are review of skill set of employees; communication of industry expertise to potential clients; consideration of merging with another firm to create scale and increase industry expertise; research and articles to bolster depth of industry knowledge.
- There are many questions now under strategic review by Intermediaries:
  - Should we get into distressed assets and turnarounds?
  - Volume of deals will be down in '09 and how do we adjust?
  - Financial markets are expected to tighten further (56%) and how will this impact deal volume in coming months?
  - Who are the real buyers and how much more equity will be needed? Respondents say equity percentage in deals today has doubled (67%)
  - The deal structure mix has changed (i.e. less financing, more seller assistance); this means more creativity on Intermediaries part. Negotiations in the deal process are more complicated.
  - Fee structures may need to change (35%)-i.e. more pro bono assistance up front and fee structures may need to reduce given economic condition of seller.

### **RECOMMENDATIONS**

Sellers must understand the changes in the current environment and the impact of these changes on deal structure and their expectations much more thoroughly than in the past. Intermediaries should spend much more time preparing sellers for a turbulent process and do more homework on alternative deal structures and the impact on the seller.

Include a more thorough TEAM in the early stages of the deal process (financial advisors, tax planning, life and financial impact, etc)

If industry expertise is key to the future of regional investment bankers and business brokers, more articles and initiatives to differentiate your firm are needed.

Review the process and past approach to deal book content and preparation. Buyers want more detail on cash flows and industry competitiveness and will delve deeper into these areas in due diligence. Adding depth to the deal information in key areas may benefit the deal process and will speed decision making by potential buyers.



### **Advisors to Business Owners Results:**

(CPAs, Tax Professionals, Financial Advisors, Lawyers, Exit Planning Consultants)

- Deal volume and fee income expected to drop materially in 2009
- Clients spending more time managing cash flow than planning for exit. Industry competitiveness is also high on current focus
- Clients expectations for valuation still unrealistically high (44%)
- Advisors are rethinking their business models and project a need to adjust their strategic approach to how they conduct their practice (53%).
- Questions they are pondering:
  - Do we have the right people and affiliations?
  - Marketing of the firm's expertise must be done more effectively in the future
  - Getting the attention of the business owner in this climate very difficult
  - How do professionals reset the business owner's expectations for exit results in today's environment?
  - With low interest rates and returns plus a deteriorating real estate market, how do sellers maintain lifestyles after the sale?
  - How do we advise business owners on exits when buyers are perceived to have most of the leverage in deals?
  - Owners are selling only out of necessity and are too many waiting too long? Will more businesses be for sale under adverse conditions in coming years?

### **RECOMMENDATIONS**

The value of a good TEAM advising the business owner in today's market is of paramount importance. Business owners need the assistance of financial advisors (planning for use of proceeds more complex); tax professionals and strong CPAs (complicated and deferred deal structures prevalent); and exit planning professionals (alternatives to selling the entire business or partnership exit challenges are complicated and need planning).

Financial Advisors must be more effective and involved with business owners early in the exit planning process. Lifestyle planning and use of proceeds are very challenging in today's climate and the higher deferred component of the sale proceeds means additional risk and implications to the owner's financial planning.

Other professionals involved in exit advisory work must begin to publish articles, conduct research, and communicate the implications of the changes in the deal structure more effectively. Business owners need to understand alternatives in negotiations and the impact of the higher amounts of 'seller assistance' in deals in coming years. Also more earn outs, conditions, and linkage to future performance are being demanded by buyers and this adds more complications for the seller.



All professionals involved in exit planning need to more effectively communicate to business owners the importance of planning for the exit from their business. We believe there will be a large number of businesses on the market in future years due to the number of business owners deferring the normal exit in today's market. History shows some of the best decisions are made in adverse times. Thus not only buyers but sellers must continue to do the 'right thing' for their business and understand the implications of the changing deal landscape as they contemplate ownership changes for the business which is their life in many ways.

Finally buyers need 'excellence' from professionals involved in the advisory side of exit planning. Professionals must commit themselves to continuously improving the content of the advice provided as market conditions change and evolve. We believe there have been fundamental changes in the middle-market M&A market and awareness of these changes and their implications to the deal process is vital to the success of professional advisors' business strategies and success.

We thank Exit Planning Exchange for the opportunity to conduct this survey and provide our recommendations for future success. This survey was intended to measure the current environment and provide thought provoking input to improve the strategic success of its members and those involved in advising business owners.