



Looking for a Deal?

Mergers and Acquisitions Outlook Is Good for Solidly Performing Companies

By Dave Gilroy

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Our technology and healthcare community is becoming increasingly aware that exit prospects, through sale to a strategic or financial purchaser, are currently favorable for solidly performing companies.

Focusing on "middle market" deals valued at less than \$500 million, a quick look at recent numbers provides the evidence:

- A continued upward trend in transaction value last year to \$187 billion, a 14% increase over 2003.
- An average value of \$62 million in 2004
- Improving transaction multiples as the average enterprise value to EBITDA multiple reached 7.1x in Q4 of 2004 (versus 6.4x in Q4 of 2003)
- A majority of closed deals in 2004 in the form of cash transactions involving privately owned companies
- More than 1,900 deals were closed in this middle-market category in Q1 2005 (easing some from Q4 2004)
- The highest median amount paid (\$60 million) for venture-backed companies in Q1 2005 in more than four years
- Sharp increase in total amount paid (\$7.1 billion) for venture-backed companies in Q1 2005 (exceeded any prior quarter back to early 2000).

The forces at work behind these positive trends are clear. On the M&A "supply side" we are seeing:

- Aging of venture and private equity fund portfolios
- Retiring (often early) family-held business owners who have been waiting out the last several years for better conditions
- Improving financial performance giving sellers the confidence that they can command value in the marketplace
- Ongoing corporate divestitures.

And on the "demand side" we are seeing:

- Returning focus on growth and acquisition activity among corporate buyers. More than just peaking out from the bunker mentality of recent years, some are noting a "lust for growth" that cannot be satisfied through organic growth alone
- Proliferation of middle-market buyout groups (someone coined an acronym at a recent middle-market M&A conference -- JAMMBOG -- Just Another Middle-Market Buyout Group) with enormous amounts of capital from limited partners

expecting this capital to get deployed in purchasing companies toward earning a return over the next 4 -- 6 years. Critically, these groups are now becoming increasingly comfortable with technology and technology-based services businesses. We recently witnessed remarkably receptivity in the PEG (price-to-earnings growth) market for a fast growing \$30M internet-based consumer and financial services business that we're representing in a sale of approximately 80% of the company.

- Strong interest from European and increasingly Asian corporate buyers enjoying favorable exchange rates
- Dramatically improved macro-factors including public equity markets, restrained interest rates, the willingness of banks to extend credit liberally in financing acquisitions (crucial), and (perhaps most importantly) overall business confidence levels versus the period from late 2000 through early 2003.

The portfolio aging issue is a key factor, in our region and in all regions, and a unique dynamic for this period in time. As we all painfully recall, the unprecedented spike in venture investing activity in 1997 -- 2000 has led to a large inventory of companies increasingly attentive to exit prospects. Many of these companies are not merely survivors of this worst-ever period, but are now thriving in far more healthy technology and growth services markets. With corporate buyers increasingly "knocking on doors", boards of directors and shareholders are becoming more attentive to how their companies will be received in the market if they considering selling now.

We are engaged to sell a biotech services company, for example, that received two unsolicited strategic inquiries within 60 days last quarter. We are now managing a systematic process with this client to present and position the company in the best possible way, make all potential strategic acquirers aware of the opportunity, engage a limited set of relevant financial buyers, and ensure with complete confidence that our client is able to optimize on value. Another software and services client recently noted significant M&A activity in their market segment. On the basis of strong profitability and fast growth to over \$20 million in revenues last year, this client decided that now is a good time to explore recapitalization options to take out significant liquidity for owner/managers while continuing to participate in the upside going forward.

These are all factors that business owners in this region and across the country are actively keeping in mind as they contemplate the five key issues around exit -- timing, targeting, process, structure, and value. And, frequently, internal or external events (e.g. major strategic moves by competitors, unfunded but superlative new market opportunities, an approach by a prospective strategic buyer) stir up a board level discussion of whether now is the time to explore M&A.

Next: In Part II of this article, Gilroy will explore another segment of middle-market technology and healthcare M&A that is picking up enormous momentum right now -- the consolidation of "survivor" (but still-small) VC-backed companies to form larger, far stronger and better financed growth companies able to compete effectively on the world

stage.

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