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Improving economy, stock market prompt pick-up in acquisitions

Coming out from under cover

The Business Journal of Milwaukee - by Rich Kirchen

Wiza Industries was scheduled to close at the end of 2009 until World Class Manufacturing Group emerged with an offer to buy the Muskego manufacturer out of receivership.

Bob Peltonen, chief executive officer of World Class Manufacturing, Weyauwega, combined an undisclosed amount of bank credit and equity to finance the transaction. The new owner has hired 40 employees at the Muskego plant that had 132 employees as of fall 2009. Business is picking up and Peltonen said he hopes to add more employees in the coming months at Wiza, which does machining and assembly of iron castings and high alloy forgings.

“We saw the potential of saving some of the customer base and employees,” Peltonen said.

More southeastern Wisconsin business owners are starting to see the potential for acquisitions as the economic fog is lifting and stronger companies are able to buy either weaker ones or companies whose owners are ready to sell.

Thus far, distressed transactions such as World Class Manufacturing’s Wiza purchase have been among the most active categories of deals. Other recent examples of pending distressed purchases include two Milwaukee firms — Super Steel Products Corp., both of which recently filed for receivership.

Super Steel chairman Fred Luber submitted a bid to buy Super Steel in March after it filed a voluntary debt consolidation plan under Chapter 128 of the Wisconsin Statutes. Two groups, including one led by current Milwaukee Forge president and chief executive officer David Mesick, have made bids to acquire Milwaukee Forge, which filed a petition in Milwaukee County Circuit Court in February seeking protection from creditors.

But signs are emerging that activity is increasing in 2010 for other types of acquisitions as well.

As the economy has stabilized, both buyers and sellers are feeling better about their companies and their prospects. Also contributing to the improved deal environment are a stronger stock market, a slight improvement in the credit market and the need by some private equity funds to start exiting acquisitions they made before the recession.

”I wouldn’t call it robust, but you’ve got businesses who have gotten through the worst of it and strung together two or three quarters of stable financial performance,” said Scott Fiducci, an attorney with Davis & Kuelthau SC in Milwaukee. “You’re starting to see buyers go out and start

looking again.”

Improvement seen

Any comparisons between 2010 and the past couple years should be easy because 2008 and 2009 were the worst in recent memory.

How slow was it? In 2009, the volume of transactions declined by about 50 percent from 2008, which was a year when activity dwindled to levels unseen since the last recession, said Richard Wottrich, an adviser with IMAP Chicago. A year ago, executives of nearly all businesses were worried about their financial liquidity and solvency, said Jay Rothman, an attorney with Foley & Lardner, Milwaukee.

Wottrich said international deal activity is outpacing domestic transactions, and larger deals are more viable than smaller ones. As has been the case the past two years, companies that can afford to pay all cash or make a large cash investment are in the best position to buy, he said.

“Companies that used to be laughed at because they didn’t use leverage are now in the catbird’s seat,” Wottrich said.

In other words, financing remains tight. Banks that used to provide senior debt for transactions remain largely on the sidelines, but are starting to loosen up. Banks are beginning to appraise equipment at a higher level and are encouraged by companies’ improving cash flow, said John Emory Jr. of Emory & Co., a Milwaukee mergers and acquisitions consultant.

The improved stock and debt markets have provided another source of capital.

World Class Manufacturing pulled together an increase in its credit line with First National Bank-Fox Valley and financing for equipment through Tech Financial Services of Milwaukee.

“People that can afford to do it are looking around for opportunities,” said John Hintze, a vice president with First National Bank, Menasha.

One area company tapping the more-robust stock market is Quad/Graphics Inc., Sussex, in the largest southeast Wisconsin deal in recent months. Quad announced in January its plans for a \$1.4 billion acquisition of World Color Press of Montreal.

World Color emerged from bankruptcy in summer 2009, so the deal could also be considered to involve a distressed seller. Privately held Quad/Graphics will go public, but the founding Quadracci family will retain voting control.

“The stock market absolutely is the most reliable indicator of M&A activity,” Emory said. “Sellers want to sell when their company’s values are up.”

Likewise, companies whose stock is trading at a higher price also have more currency with which to make strategic acquisitions, he said.

Earn-out option

For privately held companies where both public stock and bank debt are not available, one option is financing the deal through an earn-out, said Bill Abraham, an attorney with Foley & Lardner. These types of deals pay the seller over 18 months to two years based on their company hitting financial targets agreed to with the seller. Payments also can be based on royalties, sales or gross margin goals.

Another driver of the transaction recovery is private equity firms both as sellers and buyers. They face deadlines with their investors to sell companies in their portfolios that the funds weren't able to move during the tight credit markets. Private equity funds also need to deploy cash in their newer funds and are starting to seek investments, Milwaukee experts said.

Milwaukee investment banking firm Cleary Gull advised Ward Adhesives Inc. of Pewaukee in its November 2009 sale to Chicago private equity firm Ellipse Capital. Cleary Gull expects to close two more deals in April involving Wisconsin companies, said managing director Ron Miller.

"Our lead pipeline has doubled since the beginning of the year," Miller said.