

The following is the text of the article “Global M&A 2008 into 2009: A Tale of Two Markets” by Mark Esbeck, which was published in the June 2009 issue of *Financial Executive*:

The president of an organization of M&A advisers from around the globe gives an overview of the market — now and going forward.

“It was the best of times, it was the worst of times... it was the season of Light, it was the season of Darkness, it was the spring of Hope ...”

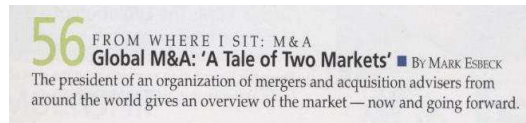
This opening to the Charles Dickens’ 1859 classic *A Tale of Two Cities* could also describe the mergers and acquisitions market from Jan. 1, 2008, up to the second quarter 2009. Better yet, this time period could aptly be described as *A Tale of Two Markets*.

In this updated version, Sept. 15, 2008, is likely to represent the line of demarcation for the change from the season of “Light” to one of “Darkness,” with respect to the M&A market. It was the date that the 2008-09 global financial and liquidity crisis firmly set hold. On this day, a shock rippled throughout the global financial community as United States investment-banking firm Lehman Brothers Holdings Inc. declared bankruptcy.

Fear and mistrust gripped capital markets. Liquidity vanished almost overnight as lines of credit were cancelled, cash calls went unanswered and new extensions of credit were postponed or refused. M&A markets took a sudden and swift turn for the worse.

Prior to that, mergers and acquisitions — and advisers to M&A — were enjoying a record year. By December, however, the 15th annual IMAP Transaction & Pricing Survey found advisers reporting noticeably fewer buyers in the market. Sellers, especially in the U.S. and Canada, were also in full retreat.

As the financial crisis deepened in the fourth quarter, the M&A market was disrupted by funding uncertainties and an expanding gap between buyer and seller valuation expectations.



The adverse conditions, first felt in North America, spread throughout Europe, the rest of the world and then to Latin America.

The Season of Light

The first nine months of 2008 were a booming time for M&A. “During the first three quarters, equity was abundant and lender financing was widely available at reasonable rates of interest. This was true throughout the world,” says Germany-based Karl Fesenmeyer, chairman of the board, IMAP Inc. and a senior M&A transaction adviser.

Transaction closings for IMAP’s adviser members also demonstrated this fact. Just a little more than 10 percent of the total M&A closings in

2008 were completed in the fourth quarter — normally a strong period of closing activity with year-end budgetary and goal pressures helping to drive transaction completion.

Transaction multiples for closed M&A deals were also reflective of changed market conditions. Transaction multiples were steadily rising during the first three quarters (hitting a high of 9.6x EBIT — earnings before interest and tax — in the third quarter) and then dipping sharply over the final three months.

“Buyers were seeking to revisit valuations, lenders were holding firm (if not retreating) on funding ratios and a large degree of insecurity overcame the deal market in the final quarter of 2008,” says Dimitri Abudi, managing director of IMAP’s office in Brazil. “It was difficult enough to keep all the parties to the transaction talking, let alone closing deals and breaking records.”

Despite the sudden fourth-quarter drop, 2008 ended up strong compared to an also strong 2007. This was in large part due to the strong first three quarters. Multiples for manufacturing companies — particularly for transactions in Europe involving larger firms — were higher in 2008 (over 2007), and this held true across the spectrum for other industries as well. Wholesale, services and health care all generated high deal multiples last year, with only technology showing a significant drop (from 6.3x to 5.4x EBIT).

The Season of Darkness

Beginning in the fourth quarter 2008 and continuing through the first two quarters of 2009, the M&A market has undergone a seismic change. As banks withdrew funding from global credit markets M&A transactions became stalled in their tracks.

“IMAP advisers have backlogs with more good quality projects than ever and a virtual lack of funding support to complete the deal,” says Abudi. “Transactions are getting completed, but there are fewer and the valuations are lower. The buyers typically do not require new funding support or the seller’s lenders are willing to finance fresh and improved credit.”

In this year’s first quarter, IMAP advisers closed 31 transactions compared with 56 in the first quarter of 2008 and 57 in 2007. This nearly 50 percent decrease reflects the difficulty in completing M&A projects and the current changed market conditions. While exact details have not yet been assessed for this group of closed transactions, the multiples are lower.

“There are a lot of deals done in the three-, four- and five-times EBIT range in 2009,” says Fesenmeyer. “This is pretty reflective of some sellers needing to sell and buyers demonstrating purchase leverage to larger degrees than a year ago.”

The forecast for 2009 that was developed by the survey has proven to be pretty accurate thus far. Respondents predicted fewer buyers, fewer sellers, substantially more restrictive bank funding, lower multiples and increased equity ratios for M&A transactions this year.

However, there have also been transactions that closed with strong multiples (even some in the low teens), which is indicative of buyers’ willingness to pay for good businesses operating under good management and with strong future prospects. The advisers predicted that attractive purchase prices and financial realities would provide stimulus to the deal market in 2009 and this has also proven to be true.

Despite many good reasons for getting deals concluded, the M&A market remains held back by a dearth of bank lending for acquisitions. Yet, there are signs that this is starting to change.

A Season of Hope

Marching toward the second half of 2009 and looking to 2010, M&A prospects appear to be improving. More banks (some even coming together to “club” deals) are becoming willing to fund transactions. The deals need to make sense from a complete business perspective and have a sensible funding and repayment structure. As Fesenmeyer says, “we are starting to gain greater reception from the lending sources.”

His statement is supported by the quality of new M&A projects generated by IMAP advisers in 2009; there have been several hundred new sale

mandates generated during the first part of the year, with selling assignments coming from all parts of the world. The buy assignments have declined from 2008 and 2007, indicating that qualified buyers are likely having less difficulty in finding deals on their own this year than in previous years, when there was much more competition for some of the same attractive acquisition candidates.

As of mid-May, sell mandates numbered more than five times those of buy mandate assignments. The ratio of recently contracted assignments reflected a ratio of almost 10 times sell assignments versus buy projects.

The M&A arena has undergone a substantial reformation over the last three quarters and is well positioned to respond to the market when it recovers. And, M&A advisers have responded by tailoring their services to focus on market requirements.

For example, Fessenmeyer and others, have developed “fast-track” M&A closing programs designed to quickly resolve distressed situations with the goal of minimizing losses, which, Fessenmeyer notes, have made “multiple winners out of disastrous situations.”

As always, willing and able investors are needed and are seeking opportunities for prudent and profitable investments.

“As the inventory of nondistressed companies shrinks in the traditional markets in the West, more investors from the West are looking at prospective investments in emerging markets,” says Fessenmeyer. At the same time, he adds, cash-rich buyers and investors in the emerging markets are looking for opportunities to expand into Europe and North America.

Light, Darkness, Hope ... Reality

Certainly the markets have been seesawing over the last 18 months and those involved in the M&A profession have had a difficult time determining exactly how to adapt to rapidly changing, uncertain conditions.

The M&A environment — normally ever-changing — is now changing even more dramatically. New countries have entered the

picture — China and India, for example — altering the landscape and changing the buying and selling equations once more simply understood by Western M&A advisers.

“Earlier, there was too much leverage supported by an imbalance in productive capacity, which fueled consumer demand for what they actually couldn’t afford,” says Abudi. “This all led to a false sense of purchasing entitlements and overly optimistic faith in an ever-expanding and supportive financial system.”

As we return to a more “normal” and realistic operating environment, the conditions supporting M&A are likely to return and lenders are likely to respond more enthusiastically to new lending opportunities. Banks need to get their own capital adequacy taken care of and are raising funding in the capital markets. Sellers are becoming more realistic and buyers are becoming more confident.

It is unlikely that we’ll see a rapid return to an exuberant M&A environment over the next several years. However, the drivers that propel M&A — need to acquire products, markets, capital and human talent — exist in greater magnitude than ever.

Mark Esbeck is president U.S.-based IMAP Inc., a global organization of merger and acquisition advisory firms, comprising 56 firms with 100 offices in 35 countries. He also has more than 25 years of transaction and investment banking experience involving hundreds of transactions across industries and markets.