The MergerExpert

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Merger & Acquisitions since 1983

Middle Market M&A Outlook:

Peter Sokoloff & Co

Today we continue the conversation we started on Tuesday, asking investment bankers and private equity groups to speculate about the coming year.

Part One of the series was an interview with Darren Snyder and Tony Danielak from Prairie Capital, a middle market private equity group in Chicago. In the second installment in this series, we sat down with Peter Sokoloff, Senior Managing Director at Peter Sokoloff & Co, a middle market investment bank in San Francisco focused on Telecom and Homeland Security, to get his thoughts on the coming year.

Cody: What are your thoughts right now on the general economy and how it will impact mid-sized private businesses?
Peter: Very positive. Most of the traditional leading and lagging indicators are up, pointing to a very good year. Unemployment claims are down, employment is up, inventories are growing, corporate earnings are improving and they've been steadily improving since mid-2010. They just kept gradually getting better in 2011 and we expect the same in 2012.

What is your outlook for the private market and the deal business in general?
The outlook is excellent. I have 9 sell side clients in-house and I just closed one. I've been in banking for a long time and have found that different strategies work in different economies. When the economy is teetering, we move to the buyside because it's hard to do sell side representation. In 2009, for example, we had 10 buyside clients and one sell side client. Now we're almost all sell side and they're all finding significant buyer interest. The only buyside clients are holdovers from a few years ago. Today we're seeing great interest in our sellers and real commitment by buyers to get deals done. By contrast, in 2009 most buyers had weak or non-existent M&A mandates.

How will the credit markets affect business this year? Do you think it will impact firms abilities to close?
We really only work with two types of buyers: big corporate buyers and very good PE groups. All of the well-heeled buyers could get capital even in the depths of the recession. The biggest impact has actually been for our clients. It's much easier for them to get credit to grow their businesses which is making them more attractive as they expand.
An example is one of our clients, a systems integrator who works internationally. A year or two ago they were trying to get capital to cover the 30-60 day gap between when they do the work for their clients and when they get paid, but they found it difficult to find the loans. Now the bank is helping significantly, even covering international accounts receivables which they wouldn't touch before. The banks aren't necessarily changing all of the equations they use to determine which loans to give, but they are getting more creative in the types of capital they're willing to extend to companies.
Are you expecting to do different types of deals in this economy or change the way your firm operates?

Other than the shift from mostly buyside to mostly sell side, we're really sticking close to our core. We're 100% M&A. We've done other things in the past, but our business is rather unique compared to other Investment Banks. Some firms are regional, they'll be in San Francisco or Los Angeles or New York and they look for deals near them. We're very industry specific, not regional. We do deals all around the world and know everyone in our industry. We really only work in two industries: telecom services/software companies and homeland security companies. We email nearly every CEO in the two industries our newsletter each week and mail them monthly. They all know exactly who we are and we usually hear about deals well before anyone else.

Are you anticipating any other changes happening in 2012?

One change that started last year that I think is only going to get stronger this year is the trend for very good private equity groups to start acting a lot more like venture capitalists used to act. I've been an investment banker since the early 1980s and until last year I used to avoid private equity groups as a general rule whenever possible because they would sign hundreds of NDAs and waste a lot of our time. Sokoloff is a small group, we don't have a lot of time to waste, so I would much rather work with industry players who will sign 25 NDAs and buy two companies a year than work with PE groups who will sign 500 NDAs and buy one company.

In 2011 we noted a very interesting change in the top tier of private equity players. I'm really seeing a lot more of the A level type [see side bar] of private equity groups showing up. We're actually starting to sell companies to private equity more often and they're starting to act like industry players. Sometimes a PE deal will even end up with a better multiple than we're getting from industry players. The multiples are closer to public ranges and while the A level groups require significantly more due diligence, the deals always end up better in the end. I admire the A level PEs. Instead of selling outright to a larger company who would likely slow down growth, these type of PE investments keep the entrepreneur engaged, creating jobs and driving our economy in the best American sense.

As an example, last year we had a $25M client that was growing very well and the owner/entrepreneurs decided they wanted to exit the company through a 100% sale. After talking with a few very good PE groups who wanted to keep them engaged as managers, they changed their minds, decided to stay on-board and keep growing the company. Everyone wins – the current owners take some money off the table and are positioned to take a second bite at the apple, the buyers have a strong ROI in the pipeline, and more people get hired, more GDP is created, etc.

Peter Sokoloff & Co break Private Equity into 3 groups:

A groups

Act a lot more like Venture Capital groups used to act in the 1980s. They look for strong companies with revenue and EBITDA who have the potential for very high growth given the right resources.

Methods

Maybe the company just created a new product or stumbled on an industry they can really expand into. They're looking to move from a $25M a year topline company to a $500M a year company. The A level private equity groups are willing to get their hands dirty and really help the companies grow top line.

B groups

Going to search through 500 companies a year and sign a lot of NDAs as well, but they're different. They're

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looking for companies where they can support management to continue good operations and usually modest top line growth.

Methods

Usually they're looking for good companies at decent valuations where they can add a little bit of leverage, pay off the leverage over a few years, and sell for a decent return. They tend not to add a ton of value but they generally reinvigorate old companies.

Conclusion

That's modestly good for the economy and they are a fit with some of our sellers.

C groups

Value hunters, searching through 500-600 companies, signing hundreds of NDAs. Looking for that diamond in the rough that they can pick up for a low price.

Methods

They fix some financial metrics and make the bottom line grow without significantly changing any of the topline numbers. They make businesses more efficient, which usually means firing rather than hiring employees.

Conclusion

They are not the kind of buyers we like to introduce our sellers to and we don't take on as sellers the kind of companies the C players like to buy.

About The Merger Expert

The Merger Expert is a merger & acquisition firm exclusively. Headquartered in Portland, Oregon, The Merger Expert represents owners of businesses with $3-$40 million in revenue range. Its founder, Michael Crawford has over 41,000 hours of merger & acquisition experience.

Expertise:

- Document Preparation.
- Strategic Marketing.
- Multiple Offers-Representing Owners.
- Negotiation.
- Due Diligence.
- Closing Document-Exhibit Preparation.
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The Merger Expert partners offer a no charge confidential session to inform business leaders about the process and pitfalls of selling their business. We believe you should be making an informed decision about what is usually your largest asset, *Your* Company. Get the information and advice you need to start from an industry trusted resource.

Schedule now the first step, to discuss your MOREsm Plan by calling (503) 516-2484.

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