

M&A deals flourish in Washington

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Mergers and acquisitions are heating up, but shaky companies need not apply.

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Michael Butler, CEO of Cascadia Capital, says it's a "Goldilocks market" for mergers and acquisitions.

Michael Butler has an effective tool for assessing the health of the mergers and acquisitions market: the number of unsolicited calls to his investment banking firm from private-equity funds looking to do deals.

In the pre-recession days of 2007, Seattle-based [Cascadia Capital](#), where Butler is chief executive, might receive 35 to 45 calls a week "from funds saying, 'Hey, I've got money to buy companies. What do you have? What are you working on?'"

During the recession, the phones fell silent—as few as two calls a week. And these days? "Now we're back up to 30 to 50 a week," Butler says.

Even in the depths of the recession, the regional M&A market didn't die completely. Deals still got done in beleaguered industries such as manufacturing, and also in banking as well capitalized institutions picked over the remains of shaky ones.

But what's happening now is a broad revival of activity, involving companies of all types and sizes—big, small, public, private—in just about every industry.

There have been some high-profile deals, such as Microsoft's acquisition of Skype for \$8.5 billion, Walgreen's purchase of drugstore.com for \$409 million, Oregon-based Precision Castparts' acquisition of Bellevue-based Primus International for \$900 million and Electronic Arts' purchase of Seattle's PopCap Games, valued at as much as \$1.3 billion.

There have also been scores of smaller deals as buyers with stockpiles of cash look for ways to deploy them.

“A lot of pent-up demand has started to develop into activity,” says Michael Brustkern, managing director of Seattle investment banking firm [Exvere Inc.](#) “We don’t see a lot of deals being closed presently, but we assume from looking at our own experience that the backlogs are growing. As we talk with the lawyers and different folks around town that are in the transactional business, we find they feel the same. They feel like we’re coming out of it. ... We’re probably in the early stages of an upturn that will probably see a lot of deals announced in the fourth quarter of this year and the first quarter of next year.”

And while activity is picking up and the multiples of cash flow or earnings before interest, taxes, depreciation and amortization (EBITDA) that sellers are getting start rising, local dealmakers say they don’t see signs of a frothy or overheated market.

As Butler puts it, “It’s a Goldilocks market. It’s not too hot, it’s not too cold, it’s just right.”

To understand what’s going on, it’s useful to look at the deals marketplace from two perspectives—that of the buyers and the sellers.

Let’s start with the buyers, who generally come in two flavors: the strategic or corporate buyers, firms that make acquisitions to extend their own operations in existing or new markets, and the financials, including investment and equity funds looking to add to their portfolios of companies.

The financial buyers are particularly motivated right now because they have a lot of cash that is earning almost nothing as long as it remains as cash. For these buyers, pressure is coming from those who have given them money to invest, who themselves are under pressure to show results. “They’re saying, ‘You have my money; either you put it to work or I want the money back,’” Butler says.

Brustkern notes that the financial buyers face a “double whammy” if they can’t find good opportunities and the money gets recalled and deployed elsewhere. “First, they don’t get paid for putting it to work. Second, they’re less likely to get it reinvested with them. If you’re running a large pension fund or a university trust fund, you’re looking for returns. You’re going to be graded on that, what you get for what you put out there.”

That pressure also helps make equity funds sellers as well. As Butler explains, “The funds have made so many investments and have not had many exits that they’re looking to make exits. They’re actively looking to sell companies.” And corporations can be strategic sellers as well as buyers. Witness Weyerhaeuser’s recent shedding of a shipping line and its hardwood lumber business as it pares itself down to a few core businesses.

The increased activity of financial buyers is aided by banks, which were once shunted to the sidelines by their own financial problems and the scrutiny of regulators, but are more willing to participate in deals now. “Private equity groups that do acquisitions were a little held back by some of the banking issues,” says Scott Hardman, managing director of Seattle-based investment bank Alexander Hutton Inc. “A number of the groups like to leverage their equity by also borrowing; in a lot of cases up until the last year or so, the banking situation didn’t allow that.”

Adds Butler, “For the good deals, the real high-quality deals, there’s no shortage of bank debt. You’re seeing banks like Wells Fargo get very aggressive and really work to facilitate transactions. Good deals will get multiple term sheets with attractive terms.”

Curt Fraser, president of middle market banking in Washington for JPMorgan Chase, says banks are more willing to participate in deals because they’re feeling more comfortable about the sustainability of the improved performance by the companies participating in those transactions.

“When you have more predictability in cash flow, banks can be more aggressive” in taking on deals, Fraser says. “When providing high levels of debt for an acquisition, banks prefer to work with companies that have consistent cash flow.”

Corporate buyers, too, have substantial cash they’d prefer to put to work. “A lot of the CFOs of public companies are sensitive to how they’re deploying capital,” Hardman says. “That’s a major discussion in a lot of the boardrooms.”

Publicly traded companies in particular want to have a growth story they can tell investors. Butler says these firms have goosed earnings by cutting costs; now they want growth, and they’re finding it’s easier to buy it than to generate it themselves.

“In many industries, the growth is fairly low or nominal,” Hardman says. “One way of putting their cash to work is in buying a company that’s strategic, that can help them in growth through product lines or channels or customer base.”

An example of that approach was British company Senior plc, an international manufacturing group, buying Damar AeroSystems of Monroe. Senior was already in the aerospace sector, but Damar “had direct delivery of assemblies right to the side of the aircraft, [a setup] which is something Senior thought was attractive,” Hardman says.

Butler adds corporate buyers are less interested in physical facilities and more focused on clients and revenue. “Companies are looking to get closer to the end user, the client,” he explains. “So we’re seeing some vertical integration in a lot of different industry sectors.”

On the selling side, business owners are doing deals because they want a return on their investment of money, time and effort, and they don’t see much to be gained by waiting on a return of the economy.

“The basic business of our M&A work is driven by demographics,” Brustkern says. “People are saying, ‘You know, in three or four years, I didn’t get any younger, my doctor’s not giving me any better news, my wife’s no less interested in being in the sun in the winter and life goes on. That changes their perspectives, plus the fact that the business for some of these firms, they’re knocking the ball out of the park. They’re hitting all-time records.’”

Hardman is a proponent of a theory he calls the money value of time (as opposed to the time value of money): For some owners, the money that might be gained by waiting is not worth the time they’ll have to put in for that potential payday. “The demographics of ownership of most

middle-market companies in our region are such that folks are still looking at retirement” in the near term. “People are saying, ‘We can probably get this. It would be great to get \$30 million, but if I got \$20 million, it’s not going to change a lot for me.’ Not to say people aren’t always interested in getting the highest price, but at what cost of waiting and time?”

It doesn’t hurt that companies are fetching more attractive prices. “The small ones are getting five to seven times cash flow valuations and the large ones go up from that,” Brustkern says.

Butler says good performance in the recession is now being rewarded. “In almost every industry we look in, what we’re seeing is the strong getting stronger,” he says. “The very best industries in each business sector [are] doing as well as or better than they did in 2006, 2007, at the expense of their competitors. A lot of those businesses now are getting offered great prices for their business.

“For the family-owned business that has thrived and done well, the patriarch or matriarch is saying, ‘We buy up our competitors, we’ve gotten stronger, it’s time to get out. I don’t want to take a chance of us dipping into a deep recession again and going through what I went through three or four years ago.’ So they’re seeing it as a window to sell.”

The recession has separated “companies with great management teams that survive [from] companies that need capital and are struggling,” Fraser says. “That’s what’s driving acquisitions. You see a lot of companies looking to grow through acquisitions. But they are being thoughtful,” looking for a company that “aligns with their objectives. They are opportunistically looking for the right fit.”

The result is multiple offers, access to bank financing and attractive term sheets for the strong. But Butler says it’s a bifurcated market. “If you’re an also-ran, you won’t have any attractive options from an M&A standpoint.”

Butler says middle-market transactions for growing companies are getting done at six to eight times EBITDA. “Some of the sectors, like social media, gaming, the numbers are off the charts,” he adds.

Social media and gaming are two sectors in which Butler sees considerable activity. Software is also strong. So are business services and transportation. (Cascadia recently worked on a deal for Tacoma-based trucking line Interstate Distributor Co.) “As the economy started to pick up the last 12 months,” he says, “the valuations and activity in the transportation sector picked up because it’s such an economically sensitive sector.”

Brustkern says aerospace remains a hot sector for activity. “We may have 35 to 50 percent of our backlog related to aerospace,” he says. Also active is the energy sector, for infrastructure and alternatives. Both Brustkern and Hardman mention the wine industry as generating more activity (see story on pge 35).

Looming over the revival of the deals market are prospects for a double-dip recession and meddling with capital-gains tax law. Brustkern says his clients aren’t fretting yet. “Washington

and the Puget Sound area have a backbone of Boeing and Microsoft and technology and agriculture and all of the other things going on here that's pretty strong," he observes. "We may be in one of those less vulnerable areas."

"We haven't seen buyers pull back," Butler adds. "Buyers remain pretty resolute."

But both he and Hardman say continued stock market volatility could put a damper on the M&A market. "During times of uncertainty, people tend to get, as one of my partners used to say, alligator arms," Hardman says. "They're not willing to reach out very far."

As for taxes, the diversion of an election year may temper interest in fiddling with the tax code through most of 2012. "We've certainly seen that [topic] as one of the drivers for people to come in and talk about their company and where things are," Hardman says. "A change from 15 to 25 or 28 percent can have an amazing impact on how much more you have to get for the company just to break even with a 15 percent capital gains rate."

For the moment, though, dealmakers like what they see in terms of interest among both buyers and sellers. Says Butler, "You've got a good market."

Recent mergers and acquisitions involving Washington companies

Paro Group (Netherlands), personalized consumer products → acquired by RPI (Tukwila)

Munitio (San Diego), consumer electronic accessories → acquired by BDA Inc. (Woodinville)

Heath Tecna (Bellingham), aircraft interiors → acquired by Zodiac Aerospace (France)

Damar Aerospace (Monroe), machine parts for aerospace → acquired by Senior plc (United Kingdom)

Primus International (Bellevue), airplane parts → acquired by Precision Castparts (Portland)

Souriau Group (France), engineered connectors → acquired by Esterline (Bellevue)

Northwest Hardwoods (Federal Way), lumber → acquired by American Industrial Partners (New York)

Applied Precision (Issaquah), biomedical imaging systems → acquired by GE Healthcare (United Kingdom)

Interstate Distributor Co. (Tacoma), trucking → acquired by Saltchuk Resources Inc. (Seattle)

Eclipse Electronic Systems (Dallas), intelligence receiver hardware → acquired by Esterline (Bellevue)

Hipcricket (Kirkland), mobile marketing and advertising → acquired by Augme Technologies (New York)

Sharper Agent (Denver), marketing for real estate agents → acquired by Market Leader (Kirkland)

Smilebox (Redmond), photo software → acquired by Incredimail (Israel)

Liberty Dialysis Holdings (Mercer Island), dialysis clinics → acquired by Fresenius Medical Care (Germany)

Dashwire (Seattle), mobile web services → acquired by HTC (Taiwan)

AdXpose (Seattle), digital advertising analytics → acquired by comScore (Reston, Virginia)

Prodiance (Pleasanton, California), enterprise risk management software → acquired by Microsoft (Redmond)

The Photolibary Group (Australia), image library → acquired by Getty Images (Seattle)

PicScout (Israel), image copyright solutions → acquired by Getty Images (Seattle)

Westwood Shipping Lines (Federal Way), overseas shipping → acquired by J-WesCo (Japan)

drugstore.com (Bellevue), online retailer → acquired by Walgreen Co. (Deerfield, Illinois)

Sur La Table (Seattle), kitchenware retailer → acquired by Investcorp (Bahrain)

Sucker Punch Productions (Bellevue), game developer → acquired by Sony Computer Entertainment (Foster City, California)

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