Stay Tuned
The M&A Sector of the Building Services Industry:

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STAY TUNED – *A Periodic Update Of The Building Services Industry's M&A Sector*

ACTIVITY IN 2012

So far, 2012 has been a big surprise to me because of the low level of M&A activity within the building services industry. I, and others too, felt that 2012 would bring a much higher level of activity than, to date, has proven to be the case. I thought that the specter of a capital gain rate increase, effective January 1, 2013, would be the driver for shareholders to consider selling their companies. Certainly, some have chosen that course and others may still decide to consider it, even though there is barely enough time to complete a transaction in 2012.

Why was my forecast incorrect? I am not sure that I have the answer, but among the reasons may be the uncertainty of whether the fiscal "*tax cliff*" will actually happen. The Congress and The Administration could intervene. Who knows? We are in the midst of a major election season, so I guess anything can happen. Another reason may be that company owners are still uncertain, or don't care about the tax impact. Selling may not be their focus now and the future is just that; *the future*! They will take their chances just as entrepreneurs have always done. I, too, have always believed that allowing tax considerations to be the entire focus of one's actions is not necessarily the way to go. However; certainly, if one feels that selling is probable in the very near future, 2012 is the year to do it. It may be too late for those that want to begin the process now, but not impossible. To complete a transaction in 2012, everything would have to be aligned and both the buyer and the seller would have to dedicate themselves to getting it done. Certainly, the pace would have to be different than what is usual.

Now, let's look at what is going on in the M&A sector.

FINANCING AN ACQUISITION

Many strategic buyers that want to acquire are still finding it difficult to secure adequate financing for a transaction. In the best of times financing came from multiple sources; the buyer's own cash, bank financing, seller financing, and finally; earn out. Now, some strategic buyers are reluctant use much of their own cash, even if they have it, and banks are reluctant to grant loans for transactions. That leaves seller financing and earn out as major components. This, in my view, is a significant factor why there have been fewer strategic buyer transactions in the industry. Fewer does not mean any; there have been some significant strategic acquisitions so far in 2012 and you will likely hear of more toward the end of the year.

Business owners want to maximize their net proceeds and, recognizing that the buyer needs to be not only financially qualified, but needs also to have a good acquisition track record. Enter the private equity firm!

As with strategic buyers, one should be selective when choosing a private equity fund with which to work. Many are qualified and have produced fine results for the companies with which they have completed transactions. Sometimes, the net results for the seller are better than a transaction done with a strategic buyer in which two companies, on all levels, must be fully integrated to achieve the best results for each group. This interaction and blending of corporate cultures can be problematic, thus inhibiting success. Some equity groups take a more active role in the acquired company going forward. Others may take a more passive role, providing financial oversight and advice and little more. No matter the level of involvement in the company, their focus is to help the acquired company be successful. I have been witness to some very successful transactions that have resulted in the acquired company growing and prospering exponentially. For the building services industry, one negative about working with them is that there is usually a very high level of adjusted *ebitda* that is required to get their attention. The usual range is $1.5 M to 4.0 M. That means that about 70% of those companies engaged in the industry will not hold interest for private equity. As usual, there can be exceptions.

Whether a strategic, or private equity buyer, the seller is often offered (*expected, in some cases*) to reinvest some of the sale proceeds into the new entity. It is a means for the buyer gaining some comfort that the seller will have *some skin in the game.* The seller may look at this a negative, perhaps because there is too little faith in the group to carry on successfully without this former owner having complete control. Others may look at this as having the opportunity to have a *second bite of the apple*. *Second bites of the ap*ple have worked out quite well recently for those sellers that reinvested part of their proceeds when they sold their companies a few years ago to what became a large company that was recently sold to an investment group. The reinvestment level is always part of the negotiation that occurs during the course of the acquisition process, but often it is as low as 5%, or can be as high as 25%, or more. It is my experience that the reinvestment structure is usually on a *pari passu* basis; that is, having shares that are on equal footing with all other shareholders.

Let's take a look at what may be ahead.

FOR THE REST ON 2012 AND 2013.

There may be a chip or two in my crystal ball since my forecast for 2012 was slightly off, however 2012 is now clearly in focus. Unless a transaction is now underway, it is doubtful that many projects will be started and finished in 2012. Not impossible; but unlikely. There are, however, some that are in various stages of the process and it is very likely that we will see additional closes in 2012.

Everyone, no matter what one's political persuasion, is eager to see the effect of the November election. It may result in business as usual, or there could be significant changes. The predicted tax cliff and the effect of the looming **Affordable Health Care Act** (*Obamacare*) will have some effect on earnings for many companies. The industry will sort this out, but I think 2013 will be a year of transition as companies grapple to achieve the earnings levels of the past. It will not necessarily be a year of doom and gloom, but managers will have to figure out how to stay ahead. Nothing is new, really. The industry has always managed to rise above the fray. Growth may be relaxed a bit, but that too will return.

Acquisition will continue, maybe more than in 2012, or perhaps a little less robust, depending on how The Congress and The Administration handle tax reform, small business matters and , in general, the economy. Valuation, in my view, will hold the line. A company will be no less valuable in 2013 than it is in 2012, or before; that is, if the company's major indicators remain the same.

As with any acquisition before, now, or in the future, the same principals apply: *Do your homework, understand the process, know the buyer (or, seller), choose good advisors, stay engaged in the process and understand all aspects of the process and transaction.*

STAY TUNED!

Gary

PS I invite you to contact me directly about any questions or comments that you may have about what is written here. Also, please feel free to contact me about any questions that you may have about the acquisition process, valuation, or about companies that may be for sale. ***gp***