

Money, money, money: The outlook for consolidation, investment and acquisition in 2009 February 17, 2009 06:00 AM



Rich Anderson, Moss Adams Capital

Money is on everybody's minds. Some brands need it, banks have tightened lending standards, and companies with extra cash on hand are holding onto it because of the turbulent economy.

I decided to find out more about the outlook for consolidation, acquisitions and investments in 2009 by talking with six mergers and acquisitions consultants, private equity firms, investment bankers and corporate finance advisors who operate in the action sports space. Each person answered a series of questions for me.

Today, the group offers its view on whether money is out there for acquisitions, what kind of players are looking to invest, and if they are seeing more companies interested in selling. Tomorrow, they give advice to companies and entrepreneurs looking for capital. Thursday, we examine the outlook for commercial banking and factoring.

The bottom line: This is money out there for authentic brands with strong balance sheets. But if you're a founder, don't expect to take large sums off the table now. Buyers are looking for security and protection.

Is there money out there for acquisitions and investments?

Rich Anderson, managing director, Moss Adams Capital. Rich advises clients in corporate finance and mergers and acquisition transactions. He represented Ipath in its sale to Timberland.

Yes, capital is available to fund acquisitions and to back strong management teams. While in the past 18 months we've seen an extraordinary rotation of capital out of the consumer and retail sector, there are large numbers of investors who are actively seeking quality investment opportunities.



Bob Mignogna

Bob Mignogna, mergers and acquisitions consultant, former Surfing Magazine publisher. Bob represented Xcel in its sale to Billabong.

Yes, there is money out there, although clearly not as much as a year ago. Investors today are more interested in the balance sheet and less interested in the brand vibe. That's not to say that vibe is not important, but I have noticed a shift.

Tripp Baird, principal, Partnership Capital Growth. Tripp's firm advises and prepares clients seeking to raise capital and operates an investment fund. It helped Surftech secure an equity investment.

I would divide the investment community into two general "buckets." First, a group that is facing their own internal issues - either operationally (in the case of potential strategic investors) or through their portfolios (in the case of potential private equity investors) - which has them sitting on the sidelines this year.

Second is a group that is very actively looking for investment and acquisition opportunities - primarily driven by an ability to do so (they have cash to spend), and a recognition that markets have reset to more reasonable pricing expectations. I would add, however, that even that second group is very wary of the market conditions and consumer sentiment - no one wants to get burned.

Keith Miller, partner, Goode Partners. Goode Partners is a private equity firm that invests in the consumer sector. It invested in Skull Candy in 2008.

There is money out there. For the most part, the market is hearing about distressed businesses or undervalued public businesses, which would be better off private. That being said, there still remain good businesses with good brands that are keen on partnering with capital to strengthen their balance sheets. There are also some strategic people who have been there and done that, to a degree.

Christy Lowe, managing director and Nicole Fry, senior vice president, Imperial Capital. Imperial, an investment banking firm, represented Electric Visual in its sale to Volcom.

While there is capital available for acquisitions and investments and many see this as an attractive buying opportunity, both financial and strategic acquirers are remaining cautious in the current environment. Many private equity funds have cash on hand, but for many the lack of debt financing available has taken them out of competitive bidding. Also, many consumer-focused funds are focusing on internal issues within their portfolio.

There are many well capitalized strategic acquirers who have significant amounts of cash on hand, however they are focused on preserving cash, given the uncertainty in consumer spending and the difficult financing environment.

While merger and acquisition and debt and equity transaction volumes have fallen off significantly, we are seeing a trend towards more distressed activity as many companies are faced with limited financing options. One recent interesting trend we are seeing is the opportunity for companies and investors to either repurchase existing debt or acquire significant positions, including potentially controlling stakes in companies, through the acquisition of debt, as many issues are trading at significant discounts in the market.

Our firm recently advised a leading consumer products company in an acquisition effectuated through the purchase of the target's senior debt and we continue to see an increase in this type of acquisition strategy.

With respect to equity investments, we are seeing most transactions occur in the private markets and with increasing downside protection required by most investors.



Brien Rowe

Brien Rowe, founding partner and managing director, The Sage Group. Brien represents companies looking for capital or seeking to sell or to merge. Brien represented DC in its sale to Quiksilver.

What we're seeing, the overall M+A market is down. There's a significant downturn in the volume of transactions, and an even greater downturn in the dollar value of transactions. The implication is, and the data proves it out, that larger transactions have fallen off much more than smaller transactions.

It's really difficult to get financing now.

Activity exists where there's not as great a need for raising capital or a credit facility, and where it's not as difficult for the acquirer to execute. By that I mean that it's easier to take a \$30-\$50 million deal to your board for approval than a \$300-\$500 million deal. It's easier to do smaller, more niche acquisitions of brands, rather than acquiring a competitor of your equal size.

If there is money available, what type of firms/companies have the money to invest?

Rich Anderson

Certain private equity and mezzanine debt groups are actively seeking opportunities - particularly those who refused to participate in the 10+ EBITDA multiple LBO era of 2004-2007. The groups that "won" the heated auctions have some serious leverage issues in their portfolios. The more conservative investors are free of such issues and are able to focus on new investments. The strategic industry investors have been relatively idle as they assess their own operations, but I expect they will be active acquirers of brands by mid-year.

Bob Mignogna

There are many opportunities for strategic investments but few are attractive from an earnings point of view. Institutional investors appear to be on the sidelines. Some of them are having their own worries. Individual investors exist but are more cautious than before.



Tripp Baird

Tripp Baird

There are a few strategics with strong balance sheets, fewer debt providers that managed to avoid the direct hit of the mortgage-backed securities mess, and there is also a broader group of private equity funds which - either through luck or careful planning - have large unused pools of capital. In fact, there is still over \$400 billion in committed private equity funding looking for investment opportunities.

Keith Miller

Money is sitting in a lot of places. The question becomes what the investor is willing to spend it on and valuation. For the most part, private equity and strategics still have money to invest.

Nicole Fry/Christy Lowe

While investors are clearly being cautious in the current environment, private equity firms which are not faced with significant investor redemptions and strategic acquirers with excess cash positions are still looking at acquisitions to drive growth and see the current environment as a great buying opportunity.

We're seeing a combination of selective strategic players, and private equity funds in the market. These groups are being opportunistic, chasing small add-on and stand alone acquisitions, where low levels or no bank financing is needed.

Right now, for instance, I'm involved in a transaction where consideration consists of equity, sub-debt, seller paper and stock-for-stock. I think we'll continue to see more stock-for-stock transactions, or sellers issuing notes to replace loss of credit.

And, valuations are coming down or being structured with meaningful earn-outs.

Do you see acquisitions and/or investments taking place this year in the action sports space?

Rich Anderson

For certain. The true brands will attract investors or buyers. However, the un-established labels will have a difficult time attracting capital, or the attention of strategic buyers

Bob Mignogna

I expect a number of acquisitions to take place this year, possibly more in the retail sector than on the manufacturing side

Tripp Baird

I suspect there will probably be a few. The action sports space, like most, has been hit hard by the economy. We are likely to see a few strong fundamental companies with balance sheet issues that need investments to continue to grow/weather the current environment and investors with the insight to invest at attractive valuations. No economic cycle lasts forever and smart investors realize that. I'd look for a few "big deals" sooner vs. later

Keith Miller

I see both consolidation and investments.

Nicole Fry/Christy Lowe

Yes, we will see activity in the action sports space, particularly for premium brands that can demonstrate a strong history of growth and the ability to execute well in the current environment. The sector has demonstrated above average growth over the past several years and is still a sector in favor with many institutional investors as well as other apparel and sporting goods companies looking to broaden their brand and product portfolio. We believe there will be more focus on minority investments in the space, as many investors are looking to test the waters in the current environment without committing a larger portion of capital.

In November 2008, we completed a minority investment for Skullcandy. The transaction demonstrated the ability for a premium branded company with a strong track record of growth and a premium position in the marketplace can get a transaction done in the current environment at an attractive valuation.

Brien Rowe

Yes we do and are active on a couple of situations currently. There are a number of niche brands that are gaining traction and market share in this environment; good brands with capable management will always be attractive acquisition candidates.

Are you seeing a rise in companies interested in selling?

Rich Anderson

Yes, this cycle is creating severe working capital constraints. The combination of diminished consumer spending and the contraction in credit is putting a squeeze on suppliers, wholesalers and retailers. This environment has spurred a number of companies to seek a capital or strategic partner.

Bob Mignogna

There has definitely been an increase in the number of action sports businesses talking about selling, but more are talking about finding capital any way they can.

Tripp Baird

More companies are looking to raise capital because they have to. This is in contrast to a year or two ago where more entrepreneurial founders were seeing great opportunities to sell or take some money off the table. I think if you see deals done in the action sports space this year they are more likely to be either distressed acquisitions in some way, or growth equity investments with cash staying in the companies vs. outright sales.

Nicole Fry/Christy Lowe

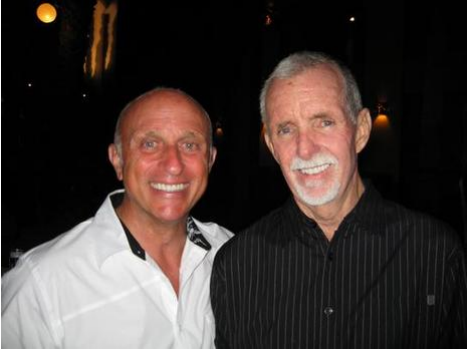
In today's environment, with public company valuations off an average of 40 percent versus last year, many companies who were entertaining a potential sale are staying on the sidelines. However, we are seeing an increase in distressed sales by companies who are unable to access capital. For many companies a sale to a larger, more financially stable acquirer is the only viable alternative in today's climate.

Brien Rowe

There's a certain sector of the market, opportunistic transactions or 'M+A out of necessity.' There are companies with a good brand that need scale which could come in the form of partnering with a larger parent with a diversified brand portfolio, international distribution capabilities and a stronger capital structure to help survive the downturn. Protection in the storm for them is to be one of the brands in a portfolio of brands.

Many are being proactive, knowing how tough the market is and working to restructure their operations. Some are really having trouble, banks are putting pressure on them, forcing them to sell - or, they see it coming and are acting ahead.

Money, money, money: Advice on how to get it and what types of companies are attracting investors February 18, 2009 07:40 AM



Bob Mignogna and Dick Baker

In Part II of our series assessing the outlook for consolidation, acquisitions and investments in 2009, I asked six experts what kind of action sports companies are attracting buyers, what it will take for investors to jump into acquisition mode, and what advice they have for executives and entrepreneurs looking to tap the capital markets.

Click [here](#) to see Part I and read who has the money and if deals are likely this year. Tomorrow, we examine the commercial banking and factor market.

Is there a particular kind of company attracting interest from buyers?

The more established brands with diversified distribution will attract the attention of buyers. Shareholders and management teams of such businesses should be sure they are ready for such a process. Proper planning and execution will enhance the likelihood of completing a deal and maximizing value.

Bob Mignogna, mergers and acquisitions consultant

I keep being asked to find a \$10m-\$20m apparel/accessory brand making money.

Tripp Baird, Partnership Capital Growth

Strong fundamental brands and companies that are competitively priced, differentiated and well marketed with a story to invest behind. We tend to think that there will be great opportunities for strong companies to take market share in this kind of environment. Two to three years ago everybody was winning. In this economy there will be fewer winners, but there is still real opportunity out there - brands and companies that will be well positioned when the markets shift.

In the action sports space, look what companies like RVCA, Obey, Nike SB/Hurley, LRG, Active, Kr3w, or Supra have done in the last five years as examples. Or Billabong on the surf side (partially through smart acquisitions). They are all brands and companies with differentiated product, strong marketing, and a strong connection to the core consumer in their respective spaces.

Keith Miller, Goode Partners

To some it is value and to some it is growth. We play more in the growth side of things than we do value, but would always look at a value play, if it was a business we understood.

Christy Lowe/Nicole Fry, Imperial Capital

Companies with premium, authentic brands are continuing to attract interest from potential buyers. We are also seeing an increasing interest among both financial and strategic acquirers in companies that have a private label component, as there is a growing trend towards private label in the marketplace.

Investors are also focused on companies with attractive distribution platforms and not a disproportionately high concentration of customers facing liquidity issues. Even companies that have filed for bankruptcy protection are seeing an interest by potential acquirers who are interested in acquiring assets if there is perceived to be inherent value in the brands.

If there are people and companies with money on the sidelines right now, what needs to happen before they feel comfortable either buying or investing in other companies?

Rich Anderson

The amount of institutional money on the sidelines is enormous. I expect that once we see the first signs of light in the consumer and retail sector there will be a burst of buying activity in the stocks of public companies in those sectors. Thereafter, an increase in private equity investments will occur.

Bob Mignogna

Prospective buyers need to see good product, growth and favorable bottom line results, especially if they are to be expected to pay well for the business.

Tripp Baird

I believe there are companies out there that are looking to invest today. But to get "back in the ring" investors need to feel confident that cash flows/profitability will stabilize, that consumers are starting to loosen their wallets, and that financing is available for strong companies from the banking community.

Keith Miller

This is more complicated than one would think. Generally, the profile of a growth investor is slightly different than a value investor. That being said, investors have to feel real comfortable in the space they are investing in and expect hold periods - the time period from when an investment is made, to when it is exited - to be slightly longer than in the past.

Christy Lowe/Nicole Fry

We believe there will need to be a stabilization in the macroeconomic environment before investors and companies begin to actively look at transactions again.

Given the extremely weak holiday selling season and continuing negative news regarding employment, consumer confidence and housing, many companies are preserving cash and focusing on internal initiatives to improve profitability. Many investors are skeptical of earnings projections in the near term given the uncertainty in the markets and thus are only willing to invest at depressed valuations, if at all.

We are hopeful that in the latter half of 2009 we will begin to see a leveling off in some of the key economic indicators (employment, housing, consumer confidence), and that will be an impetus to a rebound in activity.

Brien Rowe, The Sage Group

Well, certainly positive news in the consumer sector or improved availability of credit should spur additional M & A activity. Additionally, the news of transactions being closed with reasonable structures that make strategic sense will create some relief on the part of sellers and encourage a semblance of normalcy in the market.

Quality brands and management teams are still receiving acquisition interest in this market place.

What else can you tell our audience of executives and entrepreneurs?

Rich Anderson

Credit will remain tight throughout 2009. Alternative sources of capital will be available to established businesses with solid management teams and shareholders with realistic valuation expectations.

Bob Mignogna

Traditional capital facilities are tight and likely to be tight for awhile - make concrete financial arrangements now to carry you through 2010. Do what's best for your business to grow, not just survive. Barely surviving won't be good enough.

Tripp Baird

Hang in there, keep an open mind when it comes to financing alternatives, and if you are in a position yourself that involves the capital markets in one way or another, focus on partnership first - don't just take the money. Any investment should be a real partnership more than anything else. Partnership first, capital and hopefully growth to follow.

Christy Lowe/Nicole Fry

It is a difficult time to raise capital and the cost of capital has increased dramatically over the last six months. However, companies with a strong asset and customer base will be able to access the asset based loan market, as lenders are still active in this market.

With respect to raising equity, valuations have come down, so equity financing will be more dilutive than it has been in the past, but there are active equity investors who have an appetite for this market and see this as a buying opportunity. Equity investments are increasingly being structured with more downside risk protections in favor of the investor, so it is wise to present potential investors with a realistic forecast of the business so both parties are going into a transaction with their eyes wide open.

With respect to selling, we would not advise companies to pursue this in the first half of 2009 given the current environment unless it is really the only option available. However, we would advise companies that are interested in pursuing a sale to prepare in advance so that when the market window does open they are ready to hit the market, as we believe there will be a strong pipeline of deals once market conditions improve.

Brien Rowe

Both buyers and sellers have to be more creative in how transactions are priced and structured, while we wait for credit markets to return. Stock-for-stock, much greater amounts of equity, seller notes and realistic earnout provisions are all elements of successful transactions in this market. Of course, an easing of credit in the latter part of 2009 will certainly help too.