KURMANNPARTNERS
IMAP SWITZERLAND

# MERGERTALK

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Mergers & Acquisitions | Succession Solutions | Owner Strategies | Growth Strategies

## In this edition



By Peter Degen

## Sale of a Company - when is the best Time ?

It is commonly believed that low interest rates and a rising stock market would ensure a vibrant M&A market. In fact, the number of transactions and the volume in value terms remain at 2009 levels despite a stock market rally and record low interest rates. What is going on with potential buyers and sellers? What external and internal factors are having an effect on the transactional behavior of buyers and sellers? Are buyers becoming overcautious? Are sellers holding back due to a lack of alternative investment opportunities, something which has been heard more and more recently?

A clear correlation between the stock market, interest rates and M&A transactions, as was the case until three or four years ago, is something that happened in the past - if indeed there ever was a clear cut correlation (see Figure). Now decision-makers are clearly of the opinion that the rise in the stock market is not based on a sustainable increase in value of listed enterprises, but rather it has been triggered by external factors such as the excessive injection of liquidity.

***Graphic: Value of Transactions (global) and Worldmarktindex MSCI World***

Kurmann Partners (Source: Zephyr (BvD) 2013, MSCI.com )

In addition, the policy of setting low interest rates has not yet significantly stirred the appetite for M&A transactions. In the past, there was a clear negative correlation between the level of interest rates and M&A activity, i.e. the lower the level of interest rates, the greater the level of activity in the M&A market. When you take into account recent developments on the M&A market, it is clear that these relationships no longer apply.

So what has changed? Kurmann Partners operates primarily in the mid-cap segment with transaction volumes of US$ 10 to 500 million. Over the past two or three years, we have noticed striking behavioral changes on the buyer and seller side in this segment, something which has in fact been accentuated over the past twelve months.

Irrespective of whether they are large corporate or medium-sized enterprises, buyers have be-

come extremely cautious. Nowadays, a due diligence process can easily run over several rounds and take six months or more. Buyers are willing to incur significant additional costs for accountants and lawyers in order to obtain a complete picture of the risks that are associated with the purchase of the target company. We also notice that buyers are dedicating many more internal resources than was common business practice previously in

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order to work through robust alternative business case simulations. As a result, the average probability of concluding a deal tends to decrease, even if the transaction is already well advanced.

We also see that sellers are increasingly trying to impose transaction structures which supposedly protect them against excessive due diligence processes and purchase price uncertainties. Lengthy due diligence processes which are highly detailed absorb key employees' time and distract them from their main tasks, meaning therefore that there may be a negative impact on the business itself in the worst case scenario. Understandably, sellers are trying to protect themselves. As a result, however, the risk of a transaction falling through at an early stage keeps increasing, even though both parties might be fundamentally interested in the transaction. The sharp rise in "locked box" contracts to hedge the purchase price instead of purchase price adjustments made at a later date, which are often laborious, indicates the trend seen whereby sellers are moving towards a seemingly "safer process". Sellers are also trying even harder to have contract negotiations concluded before the buyer actually executes due diligence. Sellers often perceive such "full coverage" approaches as a form of insurance against excessive due diligence processes and purchase price uncertainties – erroneously so, one should add.

***Definition „Locked Box"***

*The "locked box" mechanism can be defined as the buyer and seller agreeing on a fixed purchase price whereby no changes will be made to the purchase price after completion of the transaction. Instead, the purchase price is negotiated definitively based on a balance sheet – the "locked box balance sheet" – prior to the conclusion of the purchase agreement, stipulated in the purchase agreement and paid upon closure of the deal, irrespective of any balance sheet in force at the time.*

On the sellers' side, we are seeing different behavior in corporations and medium-sized enterprises. Corporations and medium-sized companies with corporate structures usually sell business units within the framework of a defined strategy. The actual timing of the transaction is primarily dictated by the strategy and less so by the market environment.

Medium-sized, owner managed companies naturally consider other criteria, too, when deciding on when to sell a business. Succession planning remains the top reason for selling. Changing competitive landscapes - new technologies, economies of scale, regulations etc - are also important triggers for entering into a selling process. However, medium-sized enterprises based in Switzerland, Europe and overseas as well are seeing alternative investment opportunities as an increasingly important decision criterion. Kurmann Partners have already been confronted with advanced projects stopping suddenly because of the fact the managing family shareholders had been unable to identify any satisfactory alternative investments for the proceeds of the sale.

It must be said that the return after taxes yielded by a healthy company cannot generally be matched by financial market investments. But is this comparison meaningful? Considering the risk profile of a professionally managed investment portfolio compared with the uncertainties of managing a company in the market place and the time which the entrepreneur has to dedicate to manage the two alternatives, it is clear that such a comparison is not useful.

Let us look again at the reasons for entrepreneurial exits and the timing for doing so. If a succession is in the pipeline, then the time remaining deemed reasonable enough for the entrepreneur to be able to continue running his or her business is the determining factor. When a changing competitive landscape is the determining factor, the point of exit depends on the "right" offer. In both cases, the professional preparation of the transaction without any pressure in terms of time is the most important value driver. If a company has to be split into various saleable units or its accounting has to be trimmed to a specific format, then we recommend a lead time of six to twelve before attempting to initiate a transaction. In any case, it is useful to plan a transaction well in advance.

Finally, if you are planning to sell your business, make sure that you obtain professional support right from the very beginning. By doing this well before the point of sale, this will help you to realize the best value for your business! You will then be able to obtain the highest value by selecting the right potential buyers and ensuring the company and respective sales documentation are aligned early on with the potential buyers in mind. A "Strategic Positioning Review" has proven to be helpful in many cases to get the process started on the right track. A professional transaction structuring and process execution also helps to achieve the optimal value with the best buyer.

***«Strategic Positioning Review»***

*Are you considering selling your business or part of it? Are you having second thoughts on your business strategy and would like to have it validated? We would be delighted to offer you our "Strategic Positioning Review" service package. Call us or contact us by email. Our partners Juerg Kurmann, Dr. Christoph Bieri and Peter Degen are on hand to talk to you with their years of experience as industry managers and M&A transaction advisers.*

## Kurmann Partners Fall Event 2013

The topic for our this year's fall event is: **„Transforming the firm by acquisitions"**. The event will take place on **November 6, 2013, at 6pm** in the Convention Point at SIX Swiss Exchange in Zurich and will be followed by an Apéritif. Please save the date.

## Kurmann Partners seeks further Industry Experts

The orientation towards various industry specializations has significantly contributed to our growth. Therefore we are interested in further developing our industry expertise in further sectors and are therefore increasingly looking to cooperate with personalities who based on their professional career have deep know-how of trends and success factors of a specific industry and have good contacts with decision makers. Within of our proven cooperation model industry experts can assist in the acquisition and execution of projects. Juerg Kurmann (juerg.kurmann@kurmannpartners.com) is at your disposal for any further information.

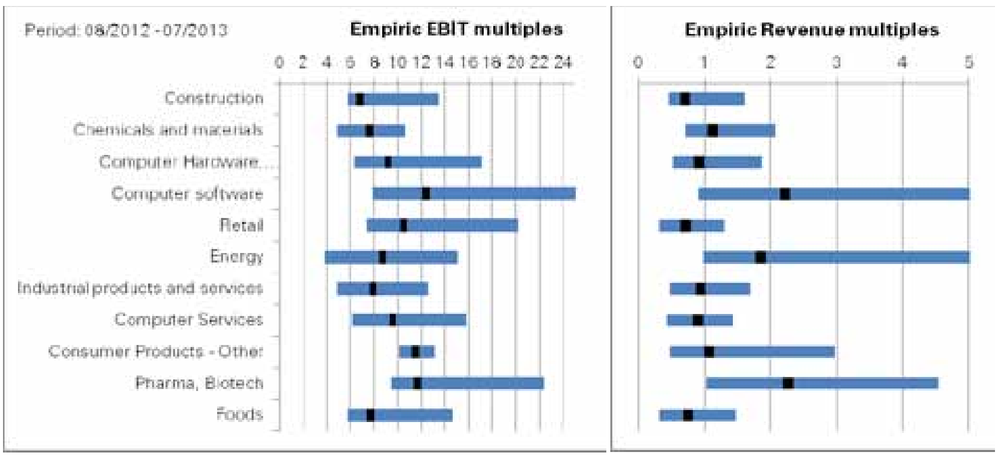
## Realized Prices

A common method for estimating the value of the company is the use of so-called «multiples». By multiplying a key figure (e.g. revenues or EBIT) of the company of interest with a sector-specific multiple the pertaining company value («enterprise value», i.e. including debt) is derived. While there are «rules of thumb multiples» for most industries, in practice they show a great variation around the mean and also vary over time.

Even though for many transactions the price details do not become public there is still a large number of transactions where target financials and transaction price are known. As a service to the readers of the MergerTalk Kurmann Partners elaborates a statistical analysis of the paid multiples of the last twelve months based on the worldwide realized sales of companies with revenues in the range $ 5- from 500 million.

In order to present meaningful data, for the calculation of the EBIT multiple we have eliminated in the basis all companies with an EBIT-margin of less than 1%. Also in the interest of clearness and to eliminate the influence of extreme special situations, we only show in the below graphic the variation over the two middle quartiles (i.e. we have eliminated the transactions with 25% lowest and the 25% highest valuations) as well as the Median (i.e. 50% of all transactions in the specific industry have a higher multiple and 50% a lower one).

As seen in the graph, the variation of the multiples is high, even within individual industries. The valuation of a company is driven by many individual and subjective factors. The exploitation of such factors in the price realization is strongly influenced by the sequence and the structure of the sales process.




Source of the basis dates: www.mergermarket.com

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**We create and realize value for our clients.**

## About us

**Kurmann Partners** is an independent M&A and strategy consulting firm, specialized in medium-sized companies. We structure and direct the process for the sale of companies, develop and implement growth through acquisitions, and consult on value-enhancing strategies.

Since 1987, we have conducted more than 100 transactions, most of them across borders. As the exclusive Swiss member of IMAP, the largest organization of independent M&A companies worldwide and with over 400 consultants in 30 countries, we have local resources, contacts, and knowledge at our disposal worldwide. All of our partners have their own company experience and can, for this reason, also develop practical solutions even in complex and demanding situations, and implement them together with the customer.

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