

## M & A in the Credit Crunch

The past few months have been a roller coaster as regards the economy and no part of the UK economy will be immune to the effects.

For Mergers and Acquisitions, the key effect of the credit crunch has been the availability of acquisition finance. Interestingly the main providers of “cash flow loans” (where the loan is based on future cash flows and not supported by assets) were RBS and HBOS, the two banks with the worst capital ratios. The difficulty in obtaining credit is however not new, and can be traced back to last year, so what has changed in the aftermath of the government bank bail-out?

The key thing is sentiment. Companies are tending to hang onto their cash, as debt finance is very difficult at present, and the same is true of raising equity on the markets (especially smaller companies on eg AIM). Valuations have undoubtedly taken a hammering, reflecting the revised economic circumstances as seen by declining P/E ratios in publicly quoted companies.

M & A activity has slowed down dramatically, particularly in the bigger, debt driven deals, but certainly not stopped in the SME market. Just as now would seem to represent a buying opportunity in the stock markets, so it is in private companies too. The difficulty is finding the company prepared to sell, and structuring a deal to meet the needs of both parties.

### **Acquirers**

As one property consultant mentioned recently, “the Bottom Feeders are out!” Whilst good businesses will not sell at rock bottom prices, Vendors will consider more flexible deal structures that would simply not have been possible in the past.

If you do have some cash, and are considering acquisition as a growth strategy, now is the time to start looking. In M & A, critical mass is key to valuation, and if you can achieve this through acquisition and then sell, it can be highly lucrative.

Alternatively if margins become under pressure, a sensibly structured deal might actually reduce your business risk. People confuse low risk with doing nothing – the two are not the same.

### **Vendors**

It may be argued that a pricing adjustment was overdue in the SME market, particularly in the minds of vendors, where matching seller and buyer price expectations was proving a stumbling block for many potential mergers. Whilst some sellers will undoubtedly postpone sale, hoping for a more conducive market in a couple of years, it is likely to take many businesses much longer to build profits back up, and may not be possible where the owner manager is already losing some of their drive.

If battling through what might be a long recession is not attractive, Vendors need to be open to more flexible deal structures, which will almost certainly involve some form of deferred consideration, earn out, or maybe share exchange.

If you decide to postpone sale, you should be prepared to stick with it at least 5 years – 2 years for business performance to pick up before sale is even considered, maybe a year to achieve the sale, and up to 2 years earn out.

### ***The outlook***

The scale of intervention in the banking sector has been so significant, that its effects will be long lasting. We cannot foresee the rapid return to easy going credit, however the costs of debt are at historically unprecedented levels, which should ease cash flow.

Companies will continue to seek growth through acquisition, but only the better deals will receive funding.

**“If the fit is good and the deal is right, we can get funding”**  
***Director of £12m acquisitive software Company***