Joining *MiBiz* for a roundtable on M&A were (top left to right) Kurt Barr of Cascade Partners LLC, Max Friar of Calder Capital LLC, Jeff Helminski of Auxo Investment Partners and John Kerschen of Charter Capital Partners; (bottom left to right) Matt Miller of BlueWater Partners LLC, Peter Roth of Varnum LLP, Tami Rua of Rua Associates LLC and Sean Welsh of PNC Bank. PHOTOS BY JEFF HAGE.

— M&A Roundtable —

MORE OF THE SAME?

Seller's market largely unfazed by rising interest rates, politics as deal flow keeps pace

By MARK SANCHEZ | MiBiz
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Professionals working in mergers and acquisitions in West Michigan expect strong deal flow to continue in 2017, maintaining a seller's market.

The group brought together by *MiBiz* for an M&A roundtable discussion generally offered favorable views of President-elect Donald Trump's pro-business policy agenda and doubted that rising interest rates would slow activity.

Participants in the roundtable discussion included:

- Kurt Barr, a director at Southfield-based investment bank **Cascade Partners LLC**
- Max Friar, managing partner at **Calder Capital LLC**
- Jeff Helminski, managing partner at private equity firm **Auxo Investment Partners**
- John Kerschen, managing director at **Charter Capital Partners**
- Matt Miller, managing partner at **BlueWater Partners LLC**
- Peter Roth, an M&A attorney and partner at **Varnum LLP**, which sponsored the roundtable
- Tami Rua, managing partner at **Rua Associates LLC** and **NuVescor Mergers & Acquisitions**
- Sean Welsh, regional president for West Michigan at **PNC Bank**

Here are the highlights of what they had to say.

What's the current state of M&A and where do you see it going?

FRIAR: I see the market as extremely strong, at least in the segment that we play in, which would be sub-$500,000 transactions — so typically very small transactions. Interest rates are obviously low and banks seem to be extremely eager to finance transactions. I feel like buyers are out there in droves, and sellers continue to enter their 60s. In most of the top transactions that we do, the sellers are doing it for retirement reasons. Overall, I'm extremely confident. (2016) has been a great year and I think (2017) is probably going to be more of the same.

MILLER: We're essentially seeing the same thing. Values are up at or near historical highs. Volumes are down a little bit the last few quarters. Regarding 2017, we're expecting healthy deal activity driven by a lot of the same factors that have been driving a strong market for the last few years. (Companies have) limited growth opportunity, a need to address disruption and transformation in industries for … strategic reasons, and — as we all know — the availability of credit and the cash on balance sheets of corporations and private equity dry powder.

ROTH: I saw a lull mid-year, and was kind of wondering whether we were at the end. I've seen a tremendous pick-up in the last couple months, and the pipeline going into '17 is probably stronger than it was going into '16. I've kind of reversed course from thinking we're tailing off a little bit to (thinking) 2017 is going to be an even better year than 2016.

The one overlay I would have on that is that while I've seen people jumping into deals, I've seen buyers be a little pickier on the diligence. I saw more busted deals in '16 than I have in other years, and where people doing deals are being a little more careful in due diligence. A few more people were willing to kill deals after they've gone a ways down the path.

HELMINSKI: What we see in the market is a stabilizing or maybe a pullback from peak pricing for companies, generally, except for those that have something truly special in the market. … Those kinds of companies are still able to get premium pricing in the market, but for companies that don't have something that special, we sort of see pricing pull back a little bit. We see continued high volumes in this market, but I do think it's going to be really end-customer market specific. There are certain things that are going to continue to be strong. There are things that are starting to pull back.

RUA: We saw the same (mid-year lull) at both Rua Associates and NuVescor, but things have just picked up drastically. I think there's still just so much pent-up demand out there for good, solid businesses with unique products or services that when we launch a project that fits that criteria, it's insane. We'll get almost 200 NDAs. I don't see how that's going to change quickly.

KERSCHEN: We really didn't see the lull this year. I look around the table and all of us have fairly small organizations, so a deal or two one way or the other can kind of affect our sentiment. But (2016) ended up being another record year and I think (for) '17, there's a renewed enthusiasm out there, particularly if we get tax cuts. People are going to seize on that, both in valuation increases from increased available cash, but also there may be some feeling that 'We'll take it while it's there. It may not last forever.' The general inclination is that over time, taxes are going up, but if we happen to get a cut over a period of time, grab it while it's there.

WELSH: We've been on a great run with very low interest rates. As rates go up, that may be a catalyst for some sellers because I think a lot of it is as they get near the strike point of their deal, they have to try to take a look to see, 'What does life look like after I sell this company? What do I do with the money I just got?' A half-percent yield on your money was probably not as attractive as the yield you were getting on your business. That may actually help push some of the activity. When I talk to people who are preparing for the sale, sometimes they double clutch and say, 'Maybe that's not enough.' It may be enough when you get to a 2-percent, 3-percent, 4-percent yield.

BARR: I think M&A activity is strong. Early in 2016, we saw a little bit of trepidation in the market with regards to valuation and a slight decrease in some of the spaces we're playing in. As '16 played out, it came back with some force. Buyers are looking for growth. They're not necessarily achieving it organically, so they're looking for deals. There's a lot of consolidation going into accomplishing that growth, and then some transformative investments as well in technology and other things. I think we'll see that continue in '17. It's going to be a seller's market going into '17, for sure.

What are some issues that you expect to deal with in 2017?

ROTH: I saw a number of deals in '16 where I thought the diligence was more diligent. … I saw more people on the legal side drilling down into diligence, asking more questions, and a few people walking away from deals. … The other trend we saw on the legal side was around warranty insurance continuing to take on a bigger place in deals. That tends to be on the larger deals, but I've see it creep down even into some mid-market deals where people are looking for rep and warranty insurance, sometimes thinking that's a panacea and solves all the problems. It's actually a fairly intricate and complex concept. It can solve certain problems. It raises other problems and you have to have people who really know how the product works and be careful with it.

FRIAR: (O)ver the past two years, there's been more of these 'right time' sellers coming out. Their primary motivation to sell is because they're not sure what the other side of the curve looks like, but they know it's good now. Secondly would be the small sellers I deal with in construction-related companies. Two years ago, we didn't do any construction deals whatsoever. (In 2015, it) was 15 percent. (In 2016), 22 percent of our current clients are construction related. What you see in the past five years, almost across the board, is straight top and bottom line growth, and they're all exhausted. Retirement as a reason to sell — every year it's been about 60 percent of what's been driving the deal to sell, at least for us, with burnout being the umbrella.

RUA: It's funny, though. 'Retirement' is a relative term. We're talking to prospective clients who are 80 that are going, 'I don't know what I'm going to do.'

WELSH: One of the things we're starting to see, too, along those lines is some of the family businesses that have sold in the market are now re-cycling back into the private equity business. They sold, they saw the opportunity for whatever reason, they took about a month off, and they're sitting on this money and they're bored. Some of the private equity guys are probably talking to them about being investors and I think they want back in. So there's this phenomena of the money being recycled back into the market.

MILLER: Despite all of the positives in the market, and peak or near-peak valuations, we are seeing a little more stress. We worked on a few relatively large distressed deals this year, which made for a big year for us as well. (It's) something we haven't seen in a few years. Two of the situations I'm thinking of were companies that never really quite recovered from the Great Recession, exhibited a lot of the common root causes of distress, and really ran out of runway. We've been sort of leaning toward the notion that this run is running out of gas, but the election has given people's expectations a little bit of a boost. But we're hearing that's likely to be somewhat short-lived. It might give us a jolt for a year or so, but there'll be some consequences that create problems and probably create more distress.

How will higher interest rates affect M&A activity?

FRIAR: I'm not concerned. There's a lot of money on the sidelines and entrepreneurship in this area is strong. There's a lot of younger people that I'm talking to that are disenfranchised with traditional corporate structures, and they have parents and relatives that have retired, have sold their businesses and are ready to support them (in their own business). I don't think a quarter-point here and there is enough to curb any of this.

RUA: Valuations will go down when the cost of capital goes up. That's typically what happens, but it's very slow because valuations are always looking at historical data, so it doesn't change quickly. Even if the rates go up slowly, valuations will go down slowly.

HELMINSKI: I think 50 to 75 basis points doesn't materially change people's perspective. We start getting to 100 basis points and we'll start to see more of that. So I would say through 2017, my guess would be that it only has an impact around the margin.

MILLER: A lot of would-be sellers don't see a lot of good alternatives for their capital post-transaction, so rising interest rates might make the alternatives a little more attractive.

WELSH: Not only the short-term but the five- and 10-year (rates), as the slope's going up, the banks are operating with a little more margin, which should allow them to take a little more risk, along with … any regulatory changes. Those all help capital flow. I don't think we're short on capital flow right now, but it keeps the engine moving as we go forward.

How may a higher cost of credit or capital, even if it's slight or moderate, affect negotiations and deal terms?

KERSCHEN: I don't think it does for the near term, unless it's a major move. Fifty basis points doesn't change that fact that if you're private equity and you have capital and the clock's ticking. You have to get it out. It doesn't change the fact that if you're a corporate acquirer and organic growth is anemic and you have an opportunity to get a deal done. Fifty basis points doesn't matter.

HELMINSKI: It's a matter of degrees, I think. The biggest thing that I think about related to that is more the trend in higher rates into the future, and so that influences our thinking about an overall deal over time, not just about having the moment to make the acquisition. In our minds, we expect that rates are going up over time and so we build that into our thinking. But it terms of what it means, on the margins maybe it changes your perspective a little bit based on how you model it out.

Is there anything to spur any urgency to get deals done?

BARR: There's nothing stronger to motivate somebody than a high price. And the (strategic) buyers are sitting there with relatively strong balance sheets and there's plenty of other capital sources — cheap capital, and the private equity guys with piles of cash they have to deploy. If you're a seller and you need to pull the trigger in the next five years, you have to really think about it.

WELSH: Regulatory reform, offshore taxes and liquidity coming back — all these things around basic corporate tax law changes that everyone talks about (under President-elect Donald Trump). Those are all hard things, but the sentiment is that, from what I hear, something potentially good can happen. Until we identify what that is, I don't think people are making decisions based on what may happen.

KERSCHEN: I can see some delays if the idea of a tax cut does come forward. … Some people might say, 'I'm going to hold my business and see how that plays out. I don't want to sell today and then have a tax cut tomorrow and not get the benefit.' I can see some private sellers extending a little bit.

MILLER: We are seeing some motivations based on a little bit of age. Baby boomers continue to retire at very high rates. That's not changing. Companies survived and now are thriving post-Great Recession. There's been this sense that the next recession is closer than the last one and they're hearing and seeing that multiples are high (and asking) how long this thing is going to last. That is, on one hand, driving sellers into the market.


PHOTO: JEFF HAGE

> "(W)hat we're hearing from buyers and investors is that there are a few (sectors) that they think might be running out of steam, that were seriously hurt by the Great Recession and have been on a nice run. Building products is one. Auto, of course, is another. Some investors seem to be pulling back a little bit in terms of their interest in investing in those types of markets that were hurt badly (and) have been on a pretty solid run. What goes up must come down, and they figure we're probably closer to the end of the expansion of those industries."
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> — MATT MILLER, BLUEWATER PARTNERS

Who's pushing deals these days, strategic buyers or financial buyers?

ROTH: I did see a trend toward more strategic and less private equity in the back half (of 2016). Some of the larger strategics, somebody said, are getting the kind of anemic internal growth and have gotten pushed by their boards to say, 'We've been sitting there with the dry powder, private equity's been running up the valuation … and you have to do something.' So I've seen some of the larger strategics coming to market. Private equity guys — that's what they do. But I know a number of large strategics where there's just board pressure on CEOs to do deals and don't miss out on some of the M&A growth.

What are the hot sectors for buyers right now?

BARR: I would say most sectors are pretty hot. I tend to emphasize health care. It's incredibly hot. Pharma has the question mark around what Trump's going to do with drug pricing and regulation and some other things. Med device is surging a little bit. Health care services is the big spot because that's where they're trying to rein in the cost aspect for the industry. Physician practices are incredibly fragmented. You have pending Medicare changes that are driving practices to consolidate at record paces.

ROTH: For me, there aren't necessarily hot sectors as much as hot companies, those companies that can do something nobody else can or they have the great management team. If you have a great company with great people or great products, that's what's hot.

MILLER: What we see is tech has been hot and it's expected to continue to be hot. Financial services has been very active over the last many years. On the other side, what we're hearing from buyers and investors is that there are a few (sectors) that they think might be running out of steam, that were seriously hurt by the Great Recession and have been on a nice run. Building products is one. Auto, of course, is another. Some investors seem to be pulling back a little bit in terms of their interest in investing in those types of markets that were hurt badly (and) have been on a pretty solid run. What goes up must come down, and they figure we're probably closer to the end of the expansion of those industries. We expect activity there may slow down a little bit.

In the small business market, who's buying? Is it people buying jobs? Is it strategic buyers?

FRIAR: It's more people frustrated with jobs. Probably back in 2010 and '11, it was people who didn't have jobs that were tapping into a trust account or a 401(k) to buy a job. I don't see that anymore. I would say there are a lot of people, especially in this area, where there seems to be this $150,000-a-year corporate ceiling in terms of what you can make. So you have a lot of younger people that are in their 30s or 40s that are looking to make more, looking for autonomy. They want to get away from the structure of 9 to 5 and they have parents or relatives that have money and want to invest behind them. And, of course, banking (credit) is very easy at this point, too.

HELMINSKI: I've said this for a while: Your idea of freedom is relative. It depends on where you are. If you're a business owner, your idea of freedom is less responsibility 9 to 5. If you're 9 to 5 in a cubicle, your idea of freedom is running a business.

FRIAR: On why strategics are buying, (it's) a desire to add product lines, desire to bring previously outsourced capability in-house. Talent — that's a big thing. There's definitely a talent shortage here. And then obviously just to add customers and provide better service to existing customers for something that strategically fits. But I don't think those things change from year to year.

Among the auto suppliers and manufacturers in the region, is exposure to Mexico becoming a negative now given the trade rhetoric from President-elect Donald Trump?

MILLER: Good question. It creates a lot of uncertainty, for sure. It's going to create change and it remains to be seen how it affects M&A, but we do have a few clients that have plants in Mexico. One, in fact, we're raising capital for because 60 percent of their growth is in Mexico. It's always been harder to borrow in Mexico. It'll be interesting to see. If the administration gets its way, it's going to have a negative impact.

ROTH: It could also have an impact on foreign buyers, especially Chinese buyers. I saw in '16 a number of Chinese companies getting into the U.S. market for the first time in the M&A space. Will those companies be quite as bullish coming over here? And they tend to be paying high multiples for reasons that there are complications to those deals.

To keep the strong M&A market going, what would you advise the incoming presidential administration to do or not do?

RUA: I was listening to the speech that was given with the announcement with Carrier staying in Indiana, and one of the things that struck me was so much talk about regulations. Trump was talking about, as he's traveled the country, that is kind of what's on business owners' minds the most: regulations. I was glad to hear that because we see that as well. The more that we can free up some of those unnecessary shackles, I think it will be good for everyone.

HELMINSKI: Create certainty, whatever it's going to be. I don't know if anyone's read Trump's 100-day plan, but I thought it was very good. I thought if he actually uses the 100 days and gets into his 100-day plan and stops picking fights and stops tweeting, I think people will have confidence and that will be good. If he becomes erratic and unpredictable, then things won't go as well.

What's one thing he and Congress could do that would keep the wind in your sails?

WELSH: The key word is 'certainty.' You can go back and change the party who's in power, and if that party creates certainty, businesses will find a way to be successful. It's so much politics. It's 'here's the game, here's how you can play it and you know it's going to be played the same way.' That would be critical if they could do that.

RUA: The pro-business sentiment, not even specifically by policy. Just overall the sentiment of being pro-business instead of making business people out to be greedy people — that's been refreshing. Business owners we've talked to, we haven't talked to a single one who hasn't been thrilled about what's ahead. MiBiz