

To Sell or Not to Sell?

That is the Question on the Minds of Many Board Members, Executives and Investors

Board members, executives and investors alike are weighing the pros and cons of whether to sell or hold and expand their business with the prospect of a higher valuation in the future. For directors, executives and investors managing toward a liquidity event, the question of when to sell can be one of the most difficult questions to answer, but if done right, can be extremely rewarding. While some see this question as a conundrum, others embrace the issue with total clarity. Interviewer, Samantha McDermott, connected with Randy Krauthamer, Managing Director of Duff & Phelps Securities, Rich Anderson, Managing Director of Moss Adams Capital, and Chris Ivey, Shareholder and Co-Chair of Stradling's Corporate Department, about the advice they are giving their clients and the trends they see in M&A.

Samantha McDermott: *When posed with this question, how do you respond?*

Chris Ivey: The question is a difficult one because there is not one answer that fits all situations. A company needs to assess its growth prospects and the potential for a higher valuation in the future resulting from that growth versus the current M&A environment and multiples being paid for companies within the same industry. Valuations are at record highs since 2007, primarily resulting from low interest rates and competition among buyers to put excess capital to work. The general sentiment is that interest rates will increase over the next year, which will make debt more expensive, reducing leverage, and possibly reducing valuation multiples. However, given the state of the U.S. economy, international interest rates and the stance of international banking authorities, like the ECB, interest rates in the U.S. are unlikely to increase swiftly or dramatically in 2015. In addition, deal terms that affect valuation and risk allocation after closing are also seller favorable in the current environment and we don't expect significant changes on that front in 2015.

Rich Anderson: The majority of companies that we represent in M&A transactions are private enterprises. With such businesses timing is a function of emotion as much as it is of valuation – though the latter is frequently the tipping point in the decision process. The U.S. equity market has been trending up for five years and now trades near all-time highs. Such an environment compels business owners to evaluate a liquidity event. We are helping owners evaluate whether to pursue a sale now or to address specific initiatives with their business to enhance value and make them more attractive to buyers in the future.

Owners that are thinking about retiring also need to understand that their willingness to stay on post-closing can enhance value (i.e. they are not running for the exit). It takes six to eight months to complete a transaction. Beyond this period, management should expect to enter into one-to-two year employment agreements. Therefore, if you wish to retire in 2016 or 2017, you should hire a lawyer and investment banker now to start the process.

Chris Ivey: Also, companies need to be realistic and pragmatic about growth prospects. There is one thing that everyone knows about projections, that is that they will be wrong. There will be risks to meeting or exceeding projected growth rates. If those risks are significant, and particularly if the identified risks are outside of the control of management, such as regulatory risks, then pursuing a sale today may be the better decision.

Samantha McDermott: *Expanding on the responses above, if you can generalize, what do valuation multiples look like today as compared to a year ago and what changes do you anticipate in the next year?*

Randy Krauthamer: Valuation multiples, while sector specific, have generally continued to increase in the past year. However, as previously mentioned, multiples appear to be reaching their peak given the rebound in corporate profits and the vast amounts of liquidity in the market. The timing couldn't be better to take some or all of your chips off the table. However, since deals take extensive planning and preparation with an investment banker, attorney and accountant, the decision needs to start now. For business owners contemplating a transaction, 2015 represents an excellent opportunity to capitalize on valuation multiples that exceed the 2007 peak.

Rich Anderson: Multiples are up moderately in most industries over the course of 2014. We are seeing double digit EBITDA multiples for companies with growth over 15% per year, earnings momentum and strong teams executing on multiple growth initiatives. The stars are in alignment now to pursue a transaction. Multiples are at all-time highs, strategic buyers are flush with cash, public shareholders no longer are excited about stock buybacks as a sole means to deliver EPS growth -

hence acquisitions are encouraged and, as Chris points out, there is an abundance of cheap debt to finance buyouts. Shareholders should think about how they'll feel if the market trades down significantly before they complete a transaction. There was no shortage of remorse during 2009-2010.

Chris Ivey: Randy, I'd be curious to hear more of your perspective here as some have postulated that closely held business owners are less likely to sell their business now, notwithstanding high valuations, because of the lack of alternatives in which to reinvest the proceeds. Do you think this concern is affecting the behavior of closely held business owners?

Randy Krauthamer: That is a great question and one that has come up repeatedly over the past several years. While money markets and bonds offer little to no real return, the stock market has realized significant gains since 2009; much like the rebound in the value of private companies. A sale will allow the business owner to diversify from all/or most of their eggs in one basket, to diversification in a broad portfolio of real estate, stock, private equity, bonds and money markets; thus reducing the risk inherent with overexposure to one particular asset class – their business. Many business owners have reached an inflection point with their business due to size, capital commitments, age, shareholder disputes or other life events that make the lack of alternatives secondary to locking in a premium value now.

Warren Buffet amassed enormous wealth and fame for buying when others are selling and selling when others are buying. The lack of quality companies for sale has pushed valuations to the point where selling is an alternative that should be strongly considered.

Samantha McDermott: *Chris, from a legal perspective, how do the various constituencies view this question differently?*

Chris Ivey: Directors, executives and investors may all have different perspectives and it's important that each perspective be taken into consideration. From a board perspective, the directors must exercise their fiduciary duties to the stockholders and oversee management in an effort to maximize value to stockholders. That may be through a sale of the company in the short-term or pursuing growth or strategic initiatives. Executives may have a different view on how to maximize value and may be influenced by financial incentives. Stockholders may not share in some of the same financial incentives as management and both management and directors must adhere to their duties of loyalty and not let personal benefits affect their decisions that are in the best interests of stockholders. These can be complicated issues and adhering to good corporate governance practices to facilitate thoughtful and deliberate decision making is paramount.



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