2013 shaping up as year of acquisitions

High valuations, lots of cash spell plenty of opportunities

BY COLE EPLEY

Merger and acquisition activity in the U.S. improved by a modest 6.6 percent through 2012, according to investment firm William Blair & Co., but volume was up 52 percent over 2009, the slowest year for deals since 2002.

Last year was the third straight year for increasing deal volume, and industry experts and data highlight two factors that make 2013 ripe for continued improvement in the M&A space: a glut of both public and private cash on the sidelines, and valuations that, in some cases, are above levels last seen in 2007.

“The top-notch companies are receiving premium valuations that are really the highest we’ve ever seen,” says Randy Karchmer, managing partner at mergers and acquisitions advisory firm Metronome Partners LLC. “Companies have done about all the cost-cutting they can do and, in terms of earnings growth, acquisitions are certainly a very fertile growth area for those companies.”

Life after Pinnacle
One Commerce Square fiscally sound despite loss

BY ANDY ASHBY

While no one believes backfilling Pinnacle Airlines Corp.’s 170,000-square-foot hole at One Commerce Square will be a simple task, the building retains financial stability; $20 million worth of improvements are receiving premium valuations that are really the highest we’ve ever seen,” says Randy Karchmer, managing partner at mergers and acquisitions advisory firm Metronome Partners LLC. “Companies have done about all the cost-cutting they can do and, in terms of earnings growth, acquisitions are certainly a very fertile growth area for those companies.”

Related story: Incentives were numerous to lure Pinnacle Airlines Downtown, but the company won’t be leaving town with any benefits.

On the web: Check out our website for a look inside the offices that Pinnacle Airlines Corp. is leaving behind at www.memphisbusinessjournal.com.

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Acquisitions: Year shaping up to be prime for middle-market deals

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Importantly, liquidity is pervasive.

According to research service S&P Capital IQ, there is more than $2 trillion in cash and cash equivalents on the balance sheets of S&P 500 organizations. Karchmer, former co-head of the M&A group at Morgan Keegan & Co. Inc., adds that vendors estimate as much as $600 billion in additional equity capital is available on the private side of the equation, where there exists a high demand for return on capital investments.

“Private equity firms are in the business of making acquisitions or they essentially have to give money back to limited partners,” he says. “These guys have to put that money to work and they’re willing to essentially overpay for high-quality companies.”

But corporate balance sheets have held considerable cash stockpiles for “quite some time,” notes Tim Lee, managing director of the corporate valuation group at Mercer Capital, and there are additional factors to consider before assuming that cash alone will drive deal volume in 2013.

“Certainly, high levels of liquidity do not hurt M&A prospects, but many of our clients have accumulated cash for lack of faith in the quality of organic or strategic opportunities,” he says.

Lee points to availability of financing and visibility of opportunity as just two considerations required “to make a real difference” in deal volume. While tax uncertainty prompted an influx of corresponding work during the year, Lee anticipates firms working exclusively in business valuations will be hard-pressed to replicate the work load seen in 2012.

“Almost every (valuation) profession will continue toward enhanced specialization in order to serve clients with value-added advisory perspective,” he says. Still, this year should present good opportunities for healthy companies and for the firms brokering deals and performing valuations.

“There seems to be a stronger outreach from private equity as well as a willingness to examine the waters for strategic acquisitions,” Lee adds. The lure of private equity is likely to soon be evident at Metronome. David Edeleson, an associate in the firm’s Memphis office, says the private side will get a lot of attention in 2013.

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Karchmer, meanwhile, remains hopeful that private equity players could carry Metronome to its next milestone.

“The firm closed around $750 million in deal volume in 2012, and the $1 billion range is a good target for this year, especially since the firm’s “sweet spot” is the middle market, where as many as half of all U.S. M&A transactions have occurred in recent years.

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Incentives to lure Pinnacle Downtown paid dividend in securing building ownership

While numerous incentives were part of the overall strategy for luring Pinnacle Airlines Corp.’s headquarters Downtown, the airline holding company won’t be taking those benefits when it heads north this spring.

Many of the incentives were geared toward keeping One Commerce Square from going dark, according to Paul Morris, president of the Downtown Memphis Commission. Before Memphis Commerce Square Partners LLC purchased the 29-story office tower in 2010, it was owned by an out-of-town bank with no interest in investing in the property.

“Best case, it would have been like 100 N. Main. Worst case, it would be like the Sterick (Building),” Morris says, referring to the long-vacant downtown tower. “It needed major investments and the bank wasn’t willing to make them.”

Meanwhile, the national economy collapsed and there weren’t many buyers lining up for the property. Pitt Hyde, founder of AuToZone Inc., stepped in as one of the major investors in Memphis Commerce Square Partners.

“Using his money with leverage and incentives from us and the city, we put together a real estate deal that is impenetrable from (One Commerce Square) going dark again for at least the near term,” Morris says. “As bad as Pinnacle leaving is, we anticipated that might happen and built a fire wall to mitigate the damage.”

Part of that fire wall to mitigate the damage is that the city and Downtown Memphis Commission structured incentives so that Pinnacle couldn’t fly away with them.

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