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## Strategic Buyers Still in the Catbird Seat

**Today's M&A market remains weak, but strategic buyers will lead a pickup in deal activity in 2010, according to a new survey of dealmakers.**

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December 11, 2009

The mood among middle-market private-equity investors continues to be glum as 2009 comes to a close, with 87% of respondents to a recent survey by the Association for Corporate Growth (ACG) and Thomson Reuters saying the current M&A environment is fair or poor. Indeed, total deal activity for the year through November fell a third from 2008.

Thus far in 2009, strategic buyers have closed a whopping 94% of total announced mergers and acquisitions. With private-equity buyers still largely on hold, 2010 looks to be another year without much competition for CFOs looking to buy.

"Strategics for the moment have a strong advantage over private-equity firms, who have to round up bank financing to get their deals done," says Den White, senior counsel at McDermott, Will & Emery and the chairman of ACG. "Many strategics are sitting on cash or have prenegotiated lines of credit. They're not required to line up bank financing on a deal-by-deal basis."

Most survey respondents predict a moderate pickup in M&A activity in the first half of 2010, much of it involving distressed companies. More than half of private-equity respondents say they are actively pursuing such deals. Even in this arena, however, strategic buyers are expected to take the lead.

Although the M&A market has been subdued in 2009, White says he's seen strategic buyers pay strong prices for carefully considered acquisitions. "In addition to the distressed deals, there have been acquisitions by strategics who are looking for niche, highly synergistic businesses, particularly in technology and clean tech," he says. "These corporate buyers are looking to buy a technology to leapfrog their competitors or add a product line that will make them more competitive."

While valuations for certain deals remain strong, multiples for middle-market transactions in general have fallen markedly, from a high of 10.1 times EBITDA (earnings before interest, taxes, depreciation, and amortization) in 2007 to 8.4 times EBITDA today, according to survey respondents. They may go still lower: 80% of respondents say they expect to pay no more than 5 times EBITDA for targets in the next six months.

Many potential buyers say sellers' expectations have not adjusted to the new environment, however, and 37% of survey respondents cite valuation problems as the biggest hurdle for deals right now. "Sellers try to argue that you shouldn't look at the current environment when valuing their company, that it's just a bump in the road. But buyers are reluctant to buy that argument," says White.

Credit availability continues to pose a challenge for financial buyers as well, although it has fallen behind valuation concerns as the biggest obstacle to M&A activity. While survey respondents were optimistic that the debt markets would continue to rebound, with 74% predicting improvement over the next six months, more than half say they expect to have to put more equity into deals over the same time period.

Some deep-pocketed private-equity firms are working around the dearth of bank financing by doing entire deals themselves, says White. "They'll buy the whole company, run it for a while, prove that it's a strong company, and then go out and look for bank financing based on that track record," he says. "But obviously not every firm has the resources to do that."

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