Zachary Scott
INVESTMENT BANKERS

IN$IGHT REPRINT
PERSPECTIVES ON THE CAPITAL MARKETS
SUMMER 2010

The Open Window

With investors eager to make transactions, sellers are in a unique position.

by Mark D. Working

After more than two years in the doldrums, conditions are again ripe for a resurgence of mergers and acquisitions. Modest improvements in the general economy have helped, but the primary impact is the current imbalance between supply of investible funds and availability of investment opportunities. For the moment, the advantage goes to the sellers.

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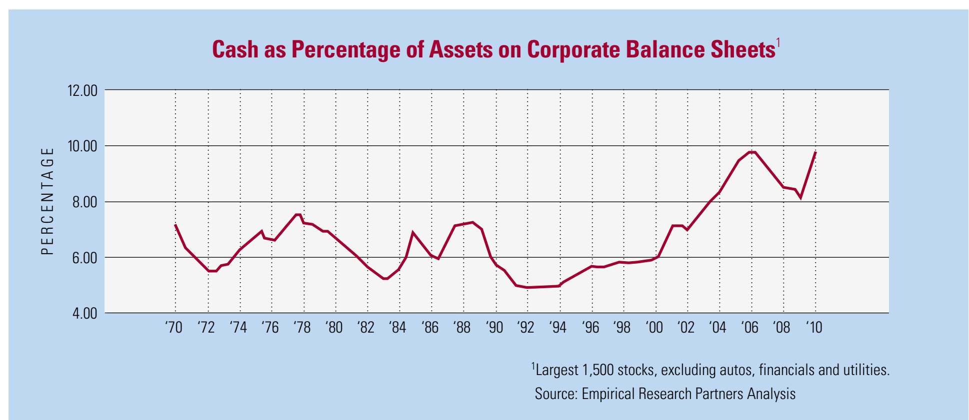
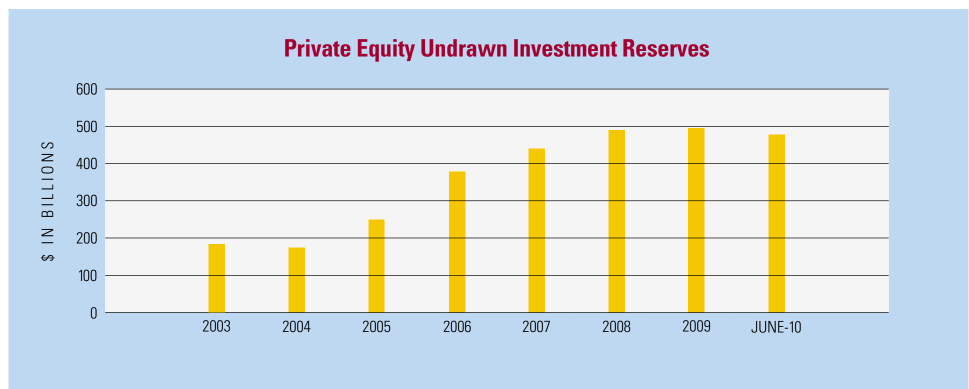
The recession has caused corporations to batten down the hatches and build cash positions. Corporate entities are well into the process of completing internal restructurings to reduce costs and trim leverage. As a result, cash as a percentage of total assets is at the highest level in forty years. Some of these businesses are now turning their heads to growth through acquisition.

Financial investors are anxious to put money to work. As discussed in the 2010 Spring edition of IN$IGHT, undrawn cash levels at private equity firms remain at record levels. Many of these firms are running out of time to put their committed funds to work. Faced with the expiration of investor commitments, a more aggressive approach is understandable. Estimates are that over half of current fund commitments will expire by the end of 2012. Given that it usually takes four years to invest a fund and many of these funds have had little or no activity, crunch time has arrived.

The other ingredient that whets the appetite for equity firm investments is the availability of debt to fund a portion of the transaction. As chronicled in IN$IGHT over the past two years, that spigot has been shut tight. Now, the pipeline has re-opened, with a growing number of transactions occurring at pre-crisis leverage levels and pricing. In a companion article on the front page, we examine the dynamics that have led to the break in the credit dike.



[1]Largest 1,500 stocks, excluding autos, financials and utilities.
Source: Empirical Research Partners Analysis



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Sellers, on the other hand, have largely sat on the bench for the past couple of years awaiting improved economic conditions. Those families and entrepreneurial founders that had thought the time was right to gain liquidity for their long hard work have put that to the back of their minds. However, the goals of liquidity and wealth diversification haven't gone away. While this pent up need waits for the opportune time, our government has

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presented another consideration as capital gains tax rates are scheduled to rise from the current 15% rate to 20% on January 1, 2011. In 2013, the new healthcare law applies Medicare taxes to capital gains. The combination represents over a 60% increase in gains taxes. Many owners are asking themselves what they can do to increase the value of the business to make up for the increased tax burden.

Those few who have recently entered the market have been favorably received. Every private equity firm we have met within the past six weeks has commented on the emergence of strategic buyers, the competition for deals, and the higher prices being paid. This current imbalance of supply and demand is creating a pricing advantage for sellers. The primary beneficiaries of these market conditions have been private equity firms selling portfolio companies. Private company owners have yet to enter the fray to any meaningful degree.

How long the window will stay open remains uncertain but, at present, strong companies are again commanding values reminiscent of pre-crisis levels. Accordingly, owners who are interested in gaining liquidity and diversifying wealth would be well served to accelerate their thinking to take advantage of a compelling market and a more favorable tax environment. ❖

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ABOUT ZACHARY SCOTT

Zachary Scott is an investment banking and financial advisory firm founded in 1991 to serve the needs of privately held, middle-market companies. The firm offers a unique combination of in-depth knowledge of the capital markets and industry competitive dynamics, sophisticated analytical capabilities, and proven expertise in structuring and negotiating complex transactions. For more information on Zachary Scott, please go to ZacharyScott.com.

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