

Mergers & Acquisitions on the rise!

There have been numerous articles written about merger activity in the transportation industry.

- Is there consolidation in our industry today? YES! YES! YES!
- Why is there a lot of activity?, a number of reasons; one reason is capacity.
- Is Private Equity “back in our space” looking for specific types of opportunities? Yes!
- Is the market paying the multiples of 2006-2007; No!

Recently, I was fortunate enough to represent Milan Express when they sold their LTL division to Vitran Corporation. Milan was positioned, as was Vitran to do something, but the timing in this transaction, is what made this an attractive opportunity for both parties.

- I have consistently stated, that, assuming that you are ready to let go, timing is everything.
- I’ve also stated, that if you are not ready to let go, or;
- You have unrealistic pricing expectations, don’t bother to go to the marketplace, because you will not be able to sell your business.

I’ve received numerous questions, from companies that want 7 to 8 times EBITDA for their business. The answer is –it won’t happen, normally!

- It is important to understand that 60% of trucking companies are 1 to 99 trucks;
- It is very difficult for a transportation Buyer, to purchase a business between \$2MM-\$10MM revenue, and have it impact their earnings.

Therefore, the types of values that you may anticipate may be somewhat distorted.

- If you are \$250MM-\$500 billion company;
- Will someone possibly pay you 6 to 7 times EBITDA---MAYBE!;
- If you are \$50MM company, will someone pay you 6-7 times EBITDA—probably not!

So what does that mean? It means that the market drives the purchase price; don’t let any business broker, investment banker, or transportation analysts tell you that they control the “market”, because if they tell you that, look elsewhere

- I’ve been in the transportation business for 40 years;
- I’ve owned Ahern for 24 years;

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March 4, 2011

- I can guarantee you that I don't control the market;
- We have sold in excess of 300+ trucking and logistics company, but;
- The sales have all been a function of the market.
- The pricing has been a function of the market.

When you are deciding if you want to sell your business, you also have to be able to review objectively what the market is willing to pay. It is very important to understand that, it is very difficult to find out the purchase prices paid by private companies purchasing other private companies. Therefore, when you look to the Public Sector, you will normally find public companies purchasing privately owned companies, and;

- They may be willing to pay out of the ordinary, for a specific strategic type business, but that is not the "norm", and;
- Therefore, the sales price can distort average values.

When you are deciding if you want to sell your business, you have to understand that:

- 60%-70% of the time the sale will be an asset sale;
- If you don't want to sell specific assets, then you are eliminating 60%-70% of the "marketplace" and how smart is that?
- Secondly, depending upon whether you sell to a Private Equity firm, or a trucking/logistics company will determine whether you have to leave any working capital in the business, even though it is an asset sale.

For example if a Private Equity firm purchases a business:

- The Buyer and Seller normally agree, on a specific working capital number, that is necessary to continue to operate the business;
- Once you agree to that figure, those funds need to be left in the business; it is called a working capital adjustment-YES! There is always an exception to the rule.
- However, to a certain extent, the adjustment discounts the amount of cash that you will receive from the business, at closing.

This does not mean that there is anything wrong, with this process, it simply means that you need to be prepared and understand what the process consists of depending upon who you sell to:

- Liquid assets are liquid assets:
 - a) Cash;
 - b) A/R;
 - c) 401(k)s, etc;
- They are the Seller's to keep at the time of the sale;
- If you have any prepaid deposits that can be utilized by the Buyer, normally they will be credited as used.
- If you have rolling stock, it will be purchased at Orderly Liquidation Value, not Fair Market Value;

However, with the equipment market getting tighter, that variable is going to change—assuming that we continue to have a shortage of good used equipment.

Then you get to the “Goodwill” of a business, what is it worth? The value of a business is directly proportionate to:

- Revenue size, and;
- Whether you are dealing with a strategic or capacity Buyer;

Assuming that you are dealing with a strategic Buyer, if you are a small business with \$5MM-\$10MM of revenue; with very strong earnings, you can expect to receive:

- Your liquidated balance sheet, plus;
- **1 ½ - 2 times your average earnings less your debt;**

For example: If you are trucking company that makes \$200k a year, and generates \$10MM of revenue, and you take another \$400k a year out in compensation, perks, benefits, etc;

- Your adjusted income is \$600k;

In many cases, a Buyer will determine what it will take to replace you, and then they will net the difference. So, let’s assume that number is \$500k. The “Goodwill” of the company will then be valued at \$750K to a possibly \$1MM plus assets less liabilities; however, on the other hand if you are a non-asset based company and generate, let’s say \$30MM and up in revenue;

- You have an EBITDA of \$3MM-\$4MM;
- You have had consistent growth;
- **That business could be worth 3 ½ – 4 ½ times EBITDA plus your assets less your debt;**
- Don’t forget, in some instances there will be a working capital adjustment that will be factored into the net deal.

Are there some Buyers that are willing to pay 5- 5 ½ times EBITDA---YES! However, it depends upon:

1. The size of the revenue;
2. The type of revenue;
3. Whether there are any dedicated contracts, or you service a special niche market with growth potential;

If you are an asset based company, before you go to the market place, you have to understand:

- a) What the value of your business is worth in the market place, and;
- b) What the CapEx expenses are? (capital expenditures)

CapEx expenses are very important to a transportation Buyer, or a Private Equity Firm, as CapEx expense determine the “free cash flow” of a business; for example:

1. If you own a \$100MM business;
2. That business generates \$10MM of EBITDA;
3. You have a CapEx expense that adjusts every 3or 4 years, which impacts your “free cash flow”, and;
4. **You expect to obtain 6 times EBITDA; it probably won’t happen; too much disruption in cash flow.**

In closing, as long as you are realistically priced, there are ways to drive additional value with an “earn out” provision; assuming you are willing to “put your money where your mouth is”. This will entail that you would stay a specific period of time with a Buyer. The bottom line, a great time to sell if you have something the market wants.

I predicted that the trucking economy would be strong for the next 12-18 months. However, with the problems we are experiencing in the Middle East, and with oil spiking, if that is not put under control shortly, Buyer capacity may diminish sharply.

- 2006-2007 was a great year to sell, and it will never be replicated in my lifetime
- It was like the days of Michael Milken of the 1980s, however;
- **I believe that 2011 will be a good year for people that want to protect their retirement to sell;**
- I believe that trucking is a good investment, but;
- **It’s also a cyclical business, and it’s sometimes capital intensive. The larger the CapEx expenses the smaller the Buyer market in trucking.**

I believe that Private Equity will be in “our space” for the next 12 months- assuming that the market stays strong, but after that, I believe that the sale values will change dramatically, and I don’t mean up!

If any of you have questions, please feel free to call me or email me your questions, there is no charge. However, it is important for you to understand that my firm follows the market, and the market dictates what is being paid. We have access to a substantial amount of buyouts, because we are involved in so many opportunities and we have the opportunity to review many deals that we don’t do.

So, if you want to sale, be prepared, be prepared, be prepared!

QUOTE OF THE WEEK: **“The two hardest things to handle in life, are failure and success!”** (Unknown)