

Weathering the current credit crunch

If you're considering a merger or acquisition this year, you face a far more difficult environment than that of one year ago. The collapse of the mortgage securities market and downturn in stocks have reduced liquidity across the financial markets, resulting in fewer buyers, less capital and potentially greater expenses. Today, getting a deal off the ground requires expertise, skill, tenacity — and luck.

Hard financial times

Results from the first quarter of 2008 show what many in the M&A market had already assumed: The number of completed transactions has fallen substantially. According to Piper Jaffray, there were \$29 billion in M&A deals (212 deals) in the first quarter, compared with \$219 billion (1,147 deals) over the same period the year before.

Greater difficulty in finding financing is a major reason for the slowdown. Issuance and trading are down in markets such as bank loans, mortgage-related financing, auction-rate securities and other formerly liquid sectors. What's more, many major Wall Street institutions are trying to avoid becoming a casualty of unwise decisions and economic weakness like the now-defunct financial giant Bear Stearns. As a result, access to capital is more limited, especially for smaller, less-capitalized companies.

Changing buyers

The credit crunch is changing conditions for buyers and sellers. For years, private equity firms represented a large segment of business buyers. Only a few tended to be strategic buyers — those that bought companies for their specific qualities, such as lucrative markets or valuable patents, and intended to hold onto them. The majority were financial buyers that looked for undervalued targets they could turn around and sell in a few years at a profit.

Active private-equity investment was generally favorable for sellers, as it produced a large pool of competitive bidders. This environment meant many companies were snapped up quickly. No longer. If you're planning to sell, expect fewer and more focused buyers. Most of the private-equity buyers left are strategic and likely to consider your company only if it fits their larger investment strategy.

Survival strategies

The M&A market isn't hopeless, of course. If you plan to buy or sell, consider doing the following to improve your chances of a successful transaction:

Wait for the bottom. You might want to postpone your potential acquisition or sale, if at all possible. The market may not have reached its bottom, and more dislocation is likely. Putting off an M&A for even a few months could help you avoid selling your business at a rock-bottom price or a deal whose value is dramatically reduced by the expensive debt required to finance it.

Update valuations. Because of reduced liquidity throughout the credit markets, buyers now need to finance acquisitions with a greater percentage of equity, which puts pressure on both buyers and sellers to present the best, most accurate current value of their companies. A business's value could change by the week, so appraisals by knowledgeable professionals should be performed more often.

Be flexible. If you plan to make an acquisition or sell your business despite weak credit conditions, remain as flexible as possible. Be prepared to act quickly should a good opportunity or offer come your way. This doesn't, of course, mean you should give short shrift to due diligence. Experienced advisors can assist you in evaluating a potential deal and help you include escape clauses in your purchase agreement (see "Don't forget your MAC" above) to provide an exit.

Turbulence predicted

Although it's impossible to predict the credit or M&A market's future, it's safe to say that you should be prepared for even more turbulence. Remember to keep focused on your core business strategy and you'll be less likely to become a casualty of these chaotic economic times.

Sidebar: Don't forget your MAC

If your proposed target's financial standing is deteriorating, your company may need to consider a material adverse change (MAC) provision. A MAC is typically defined as a relatively rapid change that could negatively affect a business's performance. MACs might include, for example, the target experiencing a sudden, severe decline in profitability due to the loss of a major customer.

MAC clauses generally cover the period between the dates of the seller's most recent audited financial statements and the deal closing. They allow buyers to terminate or renegotiate a deal without having to pay a reverse breakup fee. Recently, private equity firm Lone Star negotiated a 22% reduction in its purchase price for Accredited Home Lenders after alleging its target had experienced a MAC.

MAC clauses also contain a list of carve-outs — exceptions and qualifications that can't be considered when determining if a seller has experienced a MAC. These include:

- Changes in the general economy that affect the target's industry,
- Changes in securities law affecting the target,
- Changes in Generally Accepted Accounting Principles (GAAP), and
- Unpredictable events such as terrorism, war or natural disasters.

Claiming a MAC isn't something a buyer should undertake lightly. But if the alternative is paying a breakup fee or merging with a suddenly ailing company, you may want to consider it.