

Corporate Finance ADVISOR

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Tucker Capital Advisors LLC

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Capital Markets Commentary

As we enter the second internet boom, we find M&A pricing for technology companies to be back in high clover, but not as high as 1999-2000. Non-technology companies seem to be holding steady at a little over 6X average EBITDA for the under \$10MM valuations and closer to 7.5X for the under \$50MM sizes.

One factor in current M&A pricing is the flood of inflows to private equity groups. A record \$380B has been invested in growth financings and buy-outs through June (double 2005). Private equity is now a huge industry, whereas just 10 years ago, it was a small alternative investment world. Is it any wonder that buy-out funds are reporting 31.3% returns for 2005? (Thompson Financial/NVCA)

Meanwhile, the regulators are eyeing the community banks for excessive real estate lending and are proposing new regs to limit CRE lending to 100% of risk-based capital. By that measurement, a large percentage of banks are over-exposed to the vagaries of the market (bubble?).

The Back-Dated Stock Options Scandal has received a lot of press of late, particularly the 100+ publicly traded companies that have back-dated options for their officers and executives. Just another sleazy way to cheat their shareholders.

Backing Into An M&A Valuation

The typical leveraged buy-out (LBO) price is a balance between equity invested, bank debt, sub-debt and seller's debt. A transaction pricing structure might go like this. Assuming all debt must be serviced, we can determine the maximum amount of debt a transaction will bear. Assume a \$1 million cash flow and a seven year total amortization of debt. Further assume that the bank will require an important financial ratio: cash flow to debt service shall not be less than 120%. Therefore, only \$833 thousand is available to retire debt. Over a seven year schedule with interest at 9.5%, the maximum amount of debt is \$3.5 million. Now for the equity. LBO firms do not generally invest more than 30% of the transaction price, so the M&A purchase price as structured is \$5 million. Plain vanilla 5X cash flow pricing. There are many iterations and permutations (tweaking) of the above example, but transaction pricing must be supported by cash flow. There is no magic formula, but this calculation of the ability to service debt would be close.



C Corp Sale Taxation—Personal Goodwill

Small, privately-held companies that are "C" Corps face a daunting issue in the form of tax due on sale or a lower selling price. A "C" Corp which is sold as a stock sale is usually sold for less money due to the potential for off balance sheet liabilities (legal risk) and an inability to offer the acquirer depreciation of fixed assets and goodwill. A C

Form **1120**
Department of the Treasury
Internal Revenue Service

For the 174th consecutive year business owners were surveyed and found that CPAs are the most trusted business advisors (75%) who can help them to grow their businesses. □

Deal Flow

Acquisition Search: Executive seeks wholesale distribution and manufacturing companies in the Baltimore-Washington area with revenues of \$5-20MM. Any condition with upside.

Capital Raise: \$4-5MM equity for manufacturer of laboratory and analytical instruments. International sales. High growth and next-gen products.

Business Sale – Wholesale distributor of industrial supplies with \$4.5 million revenue. Excellent brand name with profitability and great location.

Business Sale – Commercial sprinkler contractor with \$8 million in revenue and high profitability. Well managed with high reputation.

Business Sale – Motor-Generator manufacturer with \$3 million in revenue. Excellent product lines. Good add-on acquisition.

Business Sale – Commercial and residential stone paving contractor with \$6 million in revenue and 9% net profit margins. Baltimore-Washington.

Business Sale – Commercial equipment leasing company with \$30 million annual volume. Well managed, profitable and scalable.

Unadvertised Deal Flow: TCA has a number of transactions that are not ready for market. Please call Brooke Tucker to discuss. □



Brooke Tucker, AM and Anne R. Meltzer, CPA/ABV are pleased to announce the formation of a new business valuation consultancy practice in recognition of the success we have enjoyed over the last several years. www.tuckerandmeltzer.com. Please call Brooke Tucker for further details. □

Corp which is sold in an asset sale faces taxation at both the corporate and shareholder levels (50+ %), but will sell for more money. The difference in purchase price dollars is somewhere around 20%. Some C Corp sellers have sought relief in an asset sale which includes a separate sale of personal goodwill to the individual owner.

Personal goodwill (as opposed to corporate) attaches to an individual and is represented by that individual's unique expertise, reputation, and relationships with customers and suppliers. Similar to a medical doctor's discrimination between personal and professional goodwill. Documenting the amount of personal goodwill (and tax savings) is tricky and requires a business valuation which specifically addresses the issue. □

Shift Happens!

A curious set of paradoxes is emerging as



the U.S. rushes to create alternative fuel sources – particularly ethanol for motor fuel.

The grain required to fill up a 25 gallon SUV tank could feed one person for a year. In Iowa, there are 25 operating ethanol plants and another 30 in the planning stages. Biofuel production is setting up a merger in the food and fuel industries. Our supermarkets will be competing with our gas

stations. If the entire U.S. corn crop were used to make ethanol, it would replace just 12% of gas consumption.

Wouldn't it be better to require automobiles to get 50 MPG? - *Editor*. □

Tucker Capital Advisors LLC

Tucker Capital Advisors LLC (TCA) is an investment banking and financial services advisory firm specializing in privately-held small and middle market companies. We provide our clients with transaction advisory services in buying, selling, valuing, financing and expanding their businesses. □

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Announcing

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Visit our web site to see the last six CFA newsletters and articles on mezzanine financing, MBO financing, ESOP Financing and business valuation. [TCA Website](#). ☐

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