ATLANTA BUSINESS CHRONICLE

November 25 - December 1, 2005

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Focused on the future: Focus Enterprises Inc.'s Jonathan Wilfong, from left, James Harper, Huxley Nixon, George Shea (seated), William Inman and Richard Cook.

'Tis the season to buy and sell companies

By Tom Barry
CONTRIBUTING WRITER

Sensing opportunity, Dick Cook joined Focus Enterprises Inc. in early October, signing on as a senior adviser with the Washington, D.C.-based investment bank that established an Atlanta office last spring.

The Atlanta beachhead serves small to midsized companies across the Southeast — businesses with between $5 million and $100 million in annual revenue — in a mergers-and-acquisitions market that's been running at a red-hot pitch.

Cook has been active in the American Electronics Association, including a stint as president, and he'd heard all the complaints about the difficulties smaller companies have in raising growth capital. Given that most of AEA's 3,000-plus members generate less than $50 million in annual revenue, procuring capital has been a major issue.

"Venture capitalists today seem to be putting larger amounts of money into later-stage companies, so raising capital is difficult for these guys," said Cook, CEO of Atlanta-based MAPICS Inc. — an IBM spinoff — from 1997 until its sale to software giant Infor last April.

"I'd heard all about Sarbanes-Oxley, too," Cook said. "Going public is a very, very expensive proposition for smaller companies in general, as well as cumbersome. The market isn't like it was five or six years ago. Today you have to be a much bigger company to afford the price of becoming public."

Times change. In the late 1990s, the IPO was the path to growth for many smaller companies. No more, and boutique investment banks like Focus Enterprises are scrambling to serve a burgeoning lower-end M-and-A market that can fly beneath the radar of larger investment banks.

“The cost of being a public company is higher today due to Sarbanes-Oxley compliance issues,” said Georgia State University’s Conrad Ciccotello, associate professor of risk management in the J. Mack Robinson College of Business.

Benston
The Breckenridge Group

“If you’re a Fortune 500 company, you can [spread the costs out] over a lot of sales. But for smaller companies, the scales have tipped toward the private side,” Ciccotello said. “These days there’s just a lot more private wealth out there investing in private companies.”

Cook liked what he saw in Focus Enterprises, which helps clients buy and sell companies in matchmaking fashion and raise growth capital. (Focus also has created its own fund for more mature companies looking for debt financing. Some $30 million of the projected $50 million fund has been raised to date.)

“The market for companies of this size is badly underserved, and I think there’s tremendous potential for us,” Cook said. “Many people founded what are now midsized businesses and want to take some money out of them. An IPO is just way off the charts for them ... and if you’re a $30 million to $40 million company, the fees the larger investment banks charge are kind of prohibitive.”

Founded in 1982, Focus Enterprises began expanding its reach several years ago and now has offices in Atlanta, Chicago and San Francisco, with Boston and Dallas planned for next year.

The five-partner Atlanta operation — composed of former C-level executives, most with CEO experience — was launched last March.

“Although we’re a generalist firm, we’re strong in such vertical markets as information technology, telecommunications, health care and business-process outsourcing,” said George Shea, the office’s managing partner. “Atlanta is full of those kinds of companies.”

Shea also noted the shift toward private capital in recent years, both in Atlanta and nationally. Contributing factors include the market downturn in the early 2000s as well as the cost and liability issues associated with Sarbanes-Oxley.

“You’re more of a target if you’re a public company today,” Shea said. “So the private equity market has really blossomed. An enormous amount of money is out there that focuses on buying all or a majority share in good companies.”

Shea isn’t the only one bullish on the M-and-A future here.

“The late 1990s was a pretty good time, too, but clearly we are in the best M-and-A market since 2000,” said Bill Benston, a partner in The Breckenridge Group, a boutique investment bank in Atlanta that dates from 1987. Its sweet spot is serving companies with between $15 million and $250 million in annual revenue.

“Besides the cost and hassle of going public, some of these stocks just don’t have the liquidity that shareholders want to see,” Benston said. “A lot of capital is out there trying to buy businesses. The demand for good companies is very, very high, and it exceeds the supply.”

Indeed, times couldn’t be better for the owner of a solid company looking to sell, he said. “Earnings are up, multiples are up and the economy is better than it was. Plus, credit isn’t as tight. Lenders are much more supportive of acquisition programs.”

“All in all, it’s a perfect [climate] for selling a business versus three or four years ago,” Benston said.

Growing through acquisition can be a daunting task for a small but ambitious company.

Shea said the buyer needs to make sure that the target company will be a good fit strategically and culturally. In addition, a laundry list of questions demand answers. “Are the financials audited?” Shea said. “What is the customer concentration? ... Recurring revenue is very important, too.”

In exploring the market, Shea taps Focus’ six-person research team in Washington, D.C. “We’ll have between 150 and 200 qualified targets for every buy-side opportunity,” he said.

Benston said it’s hard to overstate the importance of good corporate marriages. “Over the last 20 years, we’ve seen big conglomerates acquire other companies just to grow revenue,” he said. “But the bloom is certainly off that rose. The first thing a board of directors needs to look at is whether the acquisition is a good fit in terms of market, product and other factors. Then you have to figure out what you’re willing to pay for that company.”

That’s just for starters.

“Does the [target] company have a good management team?” Benston said. “How has it dealt with raw material prices?”

Mirror-image questions arise on the selling side. How financially strong is the acquiring company? How is the deal to be structured? What are the pros and cons of being paid in stock rather than cash?

Cook, who expects more boutique investment banks to enter the M-and-A arena in Atlanta, calls small to mid-sized companies “the heartland of America.”

“I’m excited about this,” he said. “These are the companies that are hiring people, creating new opportunities and inventing new things. Besides that, it’s really fun dealing with them.”

Maximizing M&As

Before buying a company:

- **Is it a fit?** Determine if the business is both a good strategic and cultural fit.
- **Examine financials.** Audited financial statements are a major advantage.
- **Parse the revenue.** Does it come from a broad base or just one or two customers? How strong are the recurring revenue streams? Have any factors artificially inflated revenue?
- **Look long term.** Are there any dangers/liabilities out on the horizon?
- **Cash on hand.** Decide how much money can be put together, which will determine the size of company to pursue.

Before selling a company:

- **Set the price.** Study comparables in the sector. Professional advice can be invaluable.
- **Determine the end goal.** Do you want to stay with the acquiring company or not? If so, in what capacity? How much control must you cede to get the money you desire?
- **The new team.** Discover what role, if any, your managment team will play with the new owners. Plus, what’s in store for your other employees?
- **Getting paid.** Learn the pros and cons of various ways of being paid. If the tender is in stock, carefully consider the stock’s long-term prospects versus cash.