M&A activity spikes in the South as buyers and sellers anticipate bubble burst, rate hike - Analysis
By Deborah Balshem
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M&A activity in the Southern US in the first half of 2015 showed no signs of fall off from the prior year, according to five industry sources.

"Usually there is a drop in the number of transactions from 4Q to 1Q, as tax-driven deals cause a flurry of year-end closings, but this was not the case in 2015," according to Frank Williamson, managing partner of FourBridges Capital.

Deal activity in the Southern States was up by approximately 25% in 1H15, said Brooks Crankshaw, CEO of Highland Ridge Capital. "In many cases, valuations and multiples are more reasonable in the South due to lower cost of living and lower real estate prices. This attracts many out-of-state investors who are being priced out of their own markets," explained Crankshaw, who said EBITDA multiples were approximately 7.3x in the South, versus approximately 10.5x in the US generally.

The South's business-friendly tax and regulatory environment allows more of the capital invested in a business to stay in the business and fuel growth, which makes companies more attractive to both financial investors and strategic buyers, the sources said. Tennessee's approach, in particular, is one of the most cohesive in the region when it comes to nurturing technological development. "Money goes to work earlier in the process, as their organized and structured accelerator model helps create early-stage investable companies," Crankshaw said.

Tax incentives in Florida and the volume of healthcare companies based there is also conducive to M&A, the sources agreed.

Uncertainty around the timing and consequences of the recently announced Federal interest rate hike and the anticipation of a frothy market beginning to level off are two significant factors expected to drive M&A throughout the remainder of the year.

"Buyers and sellers are wondering how long this bubble will last," said Andy Stockett, managing director at FourBridges. "Since 1926, there have only been five business cycles that lasted longer than 68 months. We hit that number this past January."

Private equity funds have large amounts of capital to deploy and cash is still flush on corporate balance sheets, with many companies looking to use that cash to grow through acquisition, said the sources. The most active sectors include healthcare, technology and energy.

According to FourBridges' April 2015 survey that focused on Alabama, Florida, Georgia, Mississippi, North Carolina, South Carolina and Tennessee, private equity is especially interested in manufacturing, with a majority (56%) of manufacturing business owners saying they are getting more calls from PE groups this year than last year, whereas only 36% of non-manufacturing firms are seeing an increase in PE interest.

Corporates have been slower to close than PE firms and therefore have missed out on some of the best deals, but that tendency is slowly starting to change, according to Crankshaw. The trend of PE firms selling to other PE firms also is starting to trail off, with more founder-owned companies up for sale, Williamson said. There also has been an upswing in the number of sales among companies with less than USD 20m in revenue, added Steve Sapletal, a director at West Monroe Partners.

Some of the biggest Southern deals of the year included **NXP Semiconductors NV**'s acquisition of Texas-based **Freescale Semiconductor** for USD 11.1bn; Virginia-based **MeadWestvaco Corp**'s USD 8.2bn sale to

Georgia-based **Rock-Tenn Co**; and **Energy Transfer Partners**' USD 9.4bn purchase of **Regency Energy Partners**, both based in Texas.

In healthcare, Ventas acquired Tennessee-based **Ardent Health Services** for USD 1.75bn, and the USD 1.8bn merger of **Kindred Healthcare** and Kentucky-based **Gentiva Health Services** created one of the nation's largest providers of long-term and acute-care hospitals, inpatient rehabilitation facilities, and hospice and home-health services.

Though a public offering for a technology company with several hundred million in revenue is a "sexy option" right now, most mid-sized companies are less prone to go that route, said Sapletal. Bigger companies that need large, continued infusions of capital, such as REITs, are more likely to consider the public markets, Stockett said.

Cyber security companies continue to attract "an incredible amount of interest," with many companies being acquired within a few years after start-up, Sapletal noted.

International M&A was "very quiet through the economic downturn but has come roaring back to life," according to Reed Smith partner Lex Eley, who said he did more cross border-related work in the past 12 months than in any similar period dating back to 2008, mainly related to US companies seeking outbound investments.

Overseas activity also has been expanding from traditional European markets to more "frontier" markets, such as the Middle East, Korea and South America. "Though people have been shying away from the Middle East due to the geopolitical situation, many clients are just not willing to wait any longer," Eley said. "If they don't make plays there now, they feel their competitors will."