M&A UPSURGE

M&A experts predict 2010 will be a hot year for deals driven by private equity firms investing in the market.

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Ron Edmonds doesn't measure the level of mergers and acquisitions in the Green Industry by the number of press releases that come across his desk.

Rather, he tracks how much his phone rings. And, this year, the president of Memphis, TN-based Green Industry mergers and acquisitions firm The Principium Group says his phone is ringing off of the hook.

"There's an awful lot of stuff going on," agrees Brian Corbett, the managing partner of Atlanta, GA-based CCG Consultants, which worked on the December 2009 deal between Denver-based The Green Plan and CIVC Partners and Leonard Green & Partners-backed Brickman. "We're working on six deals in the landscape industry right now."

But don't expect the "Wild, Wild West days" — a term Corbett affectionately uses to describe 1998-1999, when Houston-based Notre Capital Ventures merged seven multimillion-dollar landscape companies to form LandCare USA. After a year of heated bidding wars with TruGreen ChemLawn, the business was sold to its competitor, adding $450 million to its $820 million revenue at the time.

Today's activity might not rival that time period, but "approximately $10 trillion of personal wealth and business assets is predicted to change hands in the next five to 10 years" in many markets," explains Mark Long, a partner with BlueSky Group in Powell, OH. "It's an enormous number with enormous possibility, and it will continue to drive M&A activity."

Though private equity dollars have been in the industry for some time — Michael S. Dell's MSD Capital-backed ValleyCrest Cos. and the above mentioned Brickman, to name a few — the newest wave of private equity interest came with Gridiron Capital's formation of Yellowstone Landscape

Group in May 2008, giving it an instant $50-million industry presence. And, as a result, the past 18 to 24 months have brought additional private equity interest in the landscape industry, Long points out. An example is Progress Equity Partners recent carving of ACC Landscape out of Denver-based American Civil Constructors.

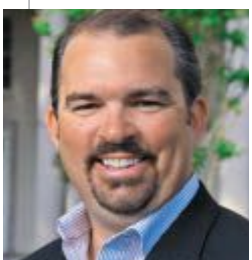
Even though Yellowstone is the furthest down the private equity path, "I think there will be one or two more new private equity buyers that will be acquiring landscape companies pretty soon," Corbett predicts.

Edmonds agrees. "I think there are some players that have visions of getting a lot bigger, and this might be their time to make a move," he says. "The landscape industry will probably evolve a bit over the next year."

"In a typical deal structure, a private equity firm is looking to invest very little of its own money — it borrows several times the size of its investments," Long adds. "Easy credit makes this work."

But today's credit market is certainly not easy. "The credit market is not perfect, but it has already improved a great deal," Edmonds says. "And the stimulation of the Small Business Administration (SBA) lending program was the most successful part of this — provisions introduced did cause SBA lending to take off, and some deals that were in discussion became viable in the fourth quarter of 2009 when deals increased."

What does this mean for 2010? "We're going to see a doubling up effect," Edmonds predicts.



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2010 = M&A double time

In 2009, there weren't as many sales of Green Industry businesses as Edmonds expected. "Last year was a slow year, which was a huge surprise to me," he shares. "I thought there would be an enormous number of people trying to exit the business coming off of a year where we had the rationing effect of commodity prices combined with gasoline prices rising so much and then the uncertainty of the economy. But that didn't materialize at all."

There are two reasons 2009 didn't turn into a banner M&A year, Edmonds believes.

First, "the world was in a state of inertia," he says. "People were hesitant to do anything. They weren't buying new houses or new cars; they weren't taking vacations."

Also, business sales happen for many more reasons than just an owner deciding to sell his company. Sometimes it's a marriage issue, a conflict with a spouse's career, a need to relocate, disability, retirement, etc. "All of those things happened last year at the same pace they usually do," Edmonds says, "but fewer deals got done — mainly because of the poor credit market."

PE squared

One can pretty quickly conduct an online search of the private equity firms interested in the landscape and lawn care business, Edmonds says. These firms raise funds from investors that are used for the equity portion of acquisitions. But those are always leveraged with other financing that is arranged deal by deal, particularly for platform acquisitions — the initial industry deal a private equity firm makes, Edmonds explains. Then after the platform acquisition, there is usually a series of follow-on acquisitions that happen much quicker and involve less complication and fewer steps because the company has established a credit agreement.

These larger private equity firms seek out $20-million-plus companies for their platform acquisitions. From there, size still matters for the majority of acquisitions — usually top 150 companies, Corbett says.

But the trend to buy good, smaller companies also is growing by private equity firms operating on a smaller scale. Brighton Partners' recent acquisition of a 70% stake in $5-million to $6-million Lawn Dawg, Nashua, NH, is a good example of this.

Then there is a third world of private equity interested in the landscape market — one backed by family wealth. "They operate the same, but are using their own money vs. raising funds," Edmonds explains, pointing to Michael Dell's MSD Capital as a good example of this type of business. "They are making the same kinds of deals but don't put out press releases like the traditional private equity firms do. These are happening just as often as the deals you do hear about."

Another big difference between these types of firms is a private equity firm backed by financing dollars usually is operating on a 5- to 7-year return-on-investment window, at which time they'll likely make the business public, sell it to another industry company or sell it to another private equity firm. The family-based companies don't seem to have these short-term exit strategies, Edmonds says.

Industry turn-ons

Regardless of the type of private equity firm, the industry businesses they are attracted to today are the same. Recurring revenue maintenance businesses continue to be more attractive than installation-focused businesses, industry consultant Judy Guido says. In fact, "many companies today are running around trying to get maintenance work to make up for how much their construction business has fallen off," she says. "Buyers aren't interested in construction even if those companies have relationships with home builders and general contractors. If they aren't building anything, so what? There is so much overbuilt stuff in commercial — and residential will be soft for a while. There's not a lot of intrinsic value there."

In addition to recurring revenue, landscape and lawn care services are tied to real estate, which remains one of the most viable assets anyone owns today. Therefore, maintenance work is a bit recession proof.

"It's something properties have to do to keep up value and appearance, and it's certainly not something you can outsource to another country," Guido adds.

Sustainability is another buzzword that's driving M&A transactions in the landscape industry. "You can't look anywhere without seeing 'green' or 'sustainable,'" Guido says, adding that companies providing water management and other "sustainable" solutions have value to buyers.

Sell, sell, sell

Not only is there more interest on the buying side, but more companies are willing to sell today.

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The challenging economy is partly to blame. A lot of owners are looking to sell because they feel increasingly vulnerable, Guido says. "The economic challenges brought their shortcomings and weaknesses to the forefront," she says. "So they think they can better protect themselves and their employees if they share the risk with someone."

Another reason is they want to diversify their net worth. "A business owner with a bigger company like those on the *LM*150 realizes he has a dilemma — 85% to 90% of his net worth is tied to one huge liquid business," Corbett says. "So diversity in net worth would help insulate him in case of another recession."

This year is also an attractive year for business mergers and acquisitions because after Dec. 31 the capital gains tax rate on selling assets is rising 33%, Corbett explains. That's in addition to the new 3.8% health care mandate for businesses with more than $200,000 in revenue. So selling now means avoiding approximately 40% in tax hikes. "These business owners are thinking, 'I can bust my butt to get my business back to where it was before the recession, but if taxes are going up that much I won't really get more than I could get by selling now,'" Corbett says.

One might think the recession would also have an impact on business valuation, but most M&A experts say this is not the case. "You might expect this to evolve into a buyer's market, but it's really not," Edmonds says. "The hesitance of sellers to sell gives them some negotiating power. Where limits come in are on the financing side."

Long agrees. "Valuations are as aggressive or solid as they've ever been because there are a lot of strategic buyers in the space," he says. Typically, maintenance companies get between 2 and 6 times EBITA and design/build companies get between 1 and 3 times EBITA, Guido says.

But, she adds, "the economy doesn't matter — good or great businesses will always be contenders to buy or be bought." LM