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Bankers Upbeat On Private Equity For 2012

By JONATHAN SHIEBER

Middle market investment bankers looking ahead to 2012 said the storm clouds that have darkened the landscape for mergers and acquisitions are finally lifting.

Thanks in part to new capital gains taxes and the sunset of the tax cuts enacted by former President George W. Bush in 2001 as well as the need among private equity investors to begin investing again after sitting out on deals in the wake of the global financial crisis, dealflow is on the rise for investment bankers servicing the middle market.

"We've never been busier," said Thomas Zucker, President of the Beachwood, Ohio-based investment banking firm Edge-Point Capital Advisors. Zucker's firm provides advisory services for companies that generate less than $100 million in revenue.

For Zucker, one reason for these expected transactions is changes to the tax code. "[The] capital gains rate is a big mental motivator for people," Zucker said. "A business owner who wants to sell his business is going to look and see 15% to 20% of his value eroded just with the incremental raise in taxes."

Under President Obama's healthcare plan, capital gains taxes will rise on Jan. 1, 2013, as a way to offset larger government healthcare costs and that, coupled with the sunset of the tax cuts enacted by former President Bush, would mean much higher taxes for business owners who sell their companies in 2013. Tax increases planned to cover the costs of new Medicare and other insurance programs as part of President Obama's plan could raise capital gains taxes to at least 23% from the current 15% rate.

If rising taxes is one reason why there could be more sellers in the market this year than last, economic conditions are also improving for small companies, according to Brian Boyle, a senior managing director with the Costa Mesa, Calif.-based middle market investment bank McGladrey Capital Markets.

"The trends are clearly moving up and there are two factors driving that. One is the economic recovery and two is the amount of private equity out there," Boyle said.

Boyle cited data from Preqin indicating that the number of transactions has been rising steadily, from 6,500 in 2009, to 7,200 in 2010, and over 8,000 deals in 2011.

"We're in a very good state of equilibrium for the deal market. Buyers can afford to pay decent prices and there are a number of sellers that for any number of reasons are looking to have a change of ownership," said Christopher H. Williams, a co-founder of the middle market investment banking firm Harris Williams.

If most bankers are sanguine about the prospects for a deal-making boom in 2012, it doesn't necessarily mean that the private equity firms involved in the deals will be reaping huge rewards. "From a private equity standpoint, the industry is getting the big squeeze," said Lloyd Greif, founder of the Los Angeles-based middle market investment bank Greif & Co.

"There is still a relatively illiquid debt market," Greif said, contradicting Williams' optimism. He said that private equity firms are under pressure to put money to work, because they didn't invest as aggressively at the bottom of the market. That means that deals are more expensive from an absolute standpoint and require more equity because lenders are still not as willing to lend as they were during the market peak in 2007.