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Once the economy improves, what will corporate buyout financing look like?

Business First of Columbus

Pat Cornelius – Partner, Squire Sanders & Dempsey LLP

The operative part of the question is "once the economy improves." Currently, traditional financing is more difficult to obtain because of increased uncertainty and the limiting of debt financing by traditional funding sources focused on increasing capital. As the financial system continues to stabilize, and the economy improves, I believe corporate buyout financing will return largely unchanged, due to the following:

• Nonperforming loans used in financing of mergers and acquisitions was not a significant factor in the financial crisis.

• New regulations should focus on more exotic financial products rather than M&A financing.

• Traditional sources of debt financing will be pressured to provide a return to their stockholders, requiring them to put capital to work through loans.

While the fundamental aspects of M&A financing will not change significantly, buyers and sellers should expect the cost of traditional funding to increase for the foreseeable future and, for this, along with other general economic conditions, to provide continued downward pressure on valuations.

Todd Kegler – Director/chairman, mergers and acquisitions, Kegler Brown Hill & Ritter Co. LPA

We believe that there is great potential for stronger middle market M&A activity in the second half. Sellers' price expectations have begun to adjust. There is a pent-up supply of deals. One middle-market investment banking firm has reported a two-year supply of transactions in its pipeline. Prospective buyers, especially private equity groups, have been sidelined since the credit markets collapsed, but are eager to re-enter the market believing there are appealing buying opportunities. The availability of lender acquisition financing remains the key question. The debt markets will need to get healthier before we see a meaningful resurgence in deal activity. We expect debt financing multiples will be lower than in the last market. A greater percentage of equity will be required, as well as more capital structure creativity (seller financing, rolled equity, earn-out structures). We also expect that regional lenders will participate more than in the last market. The lenders' underwriting standards will undoubtedly be more stringent. We believe, however, that the stage is set for improvement in the M&A market.

Peter Lieberman – Managing director, Schneider Downs Corporate Finance LP

Even if the recession ended tomorrow, buyout financing will be scarcer and more expensive than it has been for some time. Fewer banks are aggressively funding buyout loans. Competition from non-bank senior lenders, which drove up availability and cut pricing, has eroded completely. Looking ahead, we expect a recovery that will be more muted than in prior cycles. The shifting regulatory environment will play a key role in the ability of bank and non-bank lenders to fund riskier, more highly leveraged deals. And regardless of the regulators, banks themselves are likely to have limited risk appetites until their balance sheets have been cleansed. That said, capital will find its way to deals that demand it. Mezzanine funds and other junior capital sources will be active. New sources of funding from investors who see an opening to generate returns are likely to emerge in this recovery, as they have in the past.

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