

## Mergers & Acquisitions in 2011: Who's Buying, Who's Not and Why?

BY BRUCE KROPSCHOT

**With the worst of the liquidity crisis behind us**, and the previous funding constraints somewhat lifted, The Alta Group's Bruce Kropschot is optimistic ... albeit cautiously. The *Monitor* asked Kropschot to give readers his outlook on the industry's M&A landscape for 2011 and beyond.



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**O**verall U.S. merger and acquisition (M&A) opportunities appear to be primed for an upturn in 2011, after three years at depressed levels. A number of key factors are fueling this optimism for a resurgence in deal making this year and likely carrying over into 2012.

Among them are the country's improving economic environment and the performance of the stock market, factors that have stoked investor and CEO confidence. Also, the moods of buyers and sellers have been bolstered by the improved strength of the capital markets and rising company valuations.

Of particular importance is the continuing improvement in the lending environment for acquisitions. Corporations also have record levels of cash, and private equity firms have substantial funds available for investment. These factors have led buyers to be willing to pay a higher multiple of earnings. With valuations improving, corporate divestitures have increased and are projected to continue to comprise a larger share of M&A transactions in 2011. Although the big blockbuster deals make headlines, middle-market acquisitions actually have been growing and represent an increasing share of the overall market.

So, how have these factors impacted M&A opportunities in the equipment leasing and finance industry? While action has lagged behind the overall market so far, it appears conditions are favorable

for a rebound in interest in equipment leasing company acquisitions this year. The improving economy and expanded federal tax incentives bode well for increasing levels of capital equipment expenditures. The February 2011 survey of the Equipment Leasing & Finance Foundation, which measures senior executives' assessment of prevailing business conditions and expectations for the future, reached a new high since its launch two years ago.

The worst of the liquidity crisis in the capital markets also appears to be behind us, and leasing companies are now less impeded by funding constraints. Furthermore, as the economy improves bad debt, write-offs are declining for many leasing companies, resulting in higher earnings, higher business valuations and greater interest in M&A opportunities for both buyers and sellers.

### Who's Buying, Who's Not and Why?

In recent months, we have found banks to be the most interested potential buyers of equipment leasing and finance companies. During the recession, most of them experienced a considerable slide in loan demand. They now need to find higher-yielding assets than the U.S. Treasury securities that constitute a relatively high percentage of assets for many mid-sized banks. These banks are thus interested in acquiring lease and finance origination capabilities, especially in equipment areas where they do not have expertise. Because of their relatively low cost of funds, banks are also the most competitive buyers of high credit quality lease portfolios.

Most large banks have established equipment finance infrastructures, so they will likely consolidate the back-office functions of acquired businesses. There are a number of banks in the \$1 billion to \$10 billion size range, however, which do not have sizable equipment finance operations and are more likely to leave an acquired business intact. Of course, banks that are in the best position to make acquisitions are well capitalized and have not taken, or have repaid, government TARP funds.

**While other independent leasing companies also have grown through acquisitions in past years, there will be fewer opportunities in the future. They bore the brunt of the recent funding crisis, and many of them are struggling to get their debt-to-equity ratios down to levels that are now acceptable.**

Private equity firms also have made investments in several startup or relatively young equipment leasing companies in recent years. During the recession, most private equity firms reduced new investments and many now have substantial cash to deploy. Thus, there are currently a number of firms that are looking for opportunities to invest in specialty financing.

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