

Alabama and the Lively Private Equity Market

Private equity has become an important source of growth capital for private companies following the 2008 recession, but Alabama remains at the periphery of this “extremely frothy” market.

INTERVIEWS BY CHRIS MCFADYEN

Since the 2008 recession and tightening of bank lending, private companies have increasingly turned to private equity investors as a source of growth capital or merger and acquisition funding.

The four years of 2010 to 2013 saw a steady increase in private equity deals in the U.S., funded by investors — about a quarter of them public pension funds — hungry for yields purportedly higher than the stock market.

But the first three quarters of 2014 saw a slow decline in deal activity, as quality companies became harder to find, prices reached record highs and hundreds of millions in private equity funds went un-invested. Un-invested money soon reverts to the investors, so private equity brokers have been scouring the countryside.

Alabama is not in the mainstream of this churning activity, but the state is definitely part of the countryside. For insight on Alabama’s share of the activity, we talked with two specialists whose work has focused on companies in north and central Alabama.

Richard Marsden, an attorney with Lanier, Ford’s office in Huntsville, advises companies on mergers and acquisitions and — when they’re looking for private growth investment — directs them to private equity firms such as Chattanooga-based Four Bridges Capital Advisors. Andy Stockett is one of five partners at Four Bridges at the Chattanooga office, covering a territory that runs from Nashville to central Alabama.

Richard Marsden

We’re on the lower end of the spectrum. Outside of the population centers — particularly, Birmingham, Huntsville and Mobile and to some extent Montgomery — there is not much activity [in private capital investment in Alabama businesses]. It has been difficult, and there is not the kind of access to capital that you see in some of the other states. We should be doing a better job.

The wisdom is there is a lot of money nationally sitting on the sidelines waiting to invest. For small companies, since 2008, most of the bank financing is the kind of money that is lent only if you don’t need it. The lending is asset-backed, and unless you have substantial assets you’re not going to get bank loans to grow your business sufficiently. You have to look to private equity.

There is a lot of data on how much money is yet to be deployed. The numbers are staggering. The question in Alabama is whether companies can get access to it. For larger companies and successful companies in Huntsville and Birmingham, if you want to sell, the money is there to buy your company. There is a lot of that activity. The real issue is with middle-sized and smaller companies needing to get capital to grow themselves. What we are seeing are groups coming in supplanting banks, private debt deals, in which the investors, rather than take stock, take a debt position with some warrant coverage. It can be a group of high net worth individuals and they sit superior and get warrant coverage. We see some of that more than we have in the past.



Top: Richard Marsden
Above: Andy Stockett

The middle market is underserved. If you’re under \$10 million, there is not too much out-of-town money anyway. If you’re over \$50 million, you just see acquisitions. That middle range is

underserved. They don't have good access to capital for expansion and don't have access to bank debt, and they struggle to get out-of-state money. Angel groups can arrange bigger deals if they network each other.

These regional, smaller boutique investment banks have good access to who is making the smaller investments and taking minority positions in equity, and

they can go out and find a good fit. But there is always a cost associated with that.

There are not a lot of these banks in Alabama. There are a few, and there are some good ones. A couple out of Birmingham. None, really, in Huntsville. The reason that you don't see these local investment banks is that the deal flow is not large enough to support them.

Andy Stockett

This is an extremely frothy environment. I've never seen this much money chasing privately held companies. There is an overhang of \$450 billion in capital in private equity funds right now. That's the dry powder that's out there. And if they don't get it deployed, they don't get a fee. In the last 10 to 15 years, companies were valued at 4 to 6 times cash flow. Right now it's 7 to 9 times cash flow for quality companies. On the flip side, if you think about what happened in the Great Recession, a lot of corporate entities out there downsized and streamlined and hoarded cash. There's a couple of trillion on the corporate balance sheets looking for acquisitions.

Private equity funds like to buy companies with as little as \$1 million in cash flow, develop them to where there is \$10 million to \$15 million in cash flow and \$7 million to \$10 million in revenue. That's kind of the low end. We just completed an acquisition in Anniston that was in the \$500 million range, in transaction size. We have done acquisition work with companies with over \$1 billion in revenues, but our sweet spot is a \$10 million to \$75 million-revenue company. The lower middle market is what they call that.

We like Alabama a lot. We helped sell a company in Muscle Shoals, Robbins LLC, and Southern Water Consultants in Decatur, and we're working currently with a \$30 million company in the Guntersville area.* We also worked as an advisor to a company in Birmingham, Precision Husky, that makes logging equipment.

These people like funding the owner entrepreneur. The guy who started his company 25 years ago when he was laid off and the next thing he knew was running a \$15 million company in his late 60s and with no kids and there is not anybody else in the company who can take it to the next level.

** Sixty-one workers will be laid off at Robbins LLC, officials of the new owner, Hexpol, a Swedish firm, announced on December 11.*

Chris McFadyen is the editorial director of Business Alabama.

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