Colo. investment bankers share thoughts on 2008

Our panelists

Michael C. Franson
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Will Colorado companies be buying and selling as much in 2008 as before? To get a sense of the outlook for deals and the credit environment, *Rocky* Finance Editor David Milstead quizzed local investment bankers this week via e-mail. Highlights follow:

■ **Is the worst news in the credit markets behind us now?**

Franson: Probably not for some sectors of the market, particularly real estate and housing-related business. . . . It is our belief that the credit market volatility tends to be sector specific, and many sectors of the economy continue quite strong.

Seefried: Probably, but there is some small risk of a larger and significant systemic problem. Credit markets function efficiently when they have good information. Since July, the markets have been digesting a string of new information that was previously not known or generally available. There is more pain to come in subprime-land, and the spillovers will continue to impact markets, but the expectation of such events is now more anticipated. The market is conditioned for bad news.

Nielsen: No, some mortgage-backed securities originating in 2005 are beginning to trade in the range of 30 to 40 cents on the dollar, and very few mortgage-backed securities originated in 2006 or 2007 have begun to trade. When the 2006 and 2007 securities begin to trade, more write-downs will occur.

■ **What is the biggest risk factor for 2008 — the U.S. dollar, the housing market, the price of oil or something else?**

Mayer: People want to see signs that the worst is over in the well-publicized areas of difficulty — the subprime market, the housing bubble, price of the dollar. In many ways, 2008 is a wait-and-see year, particularly as the upcoming election nears.

Seefried: We will see the most discussion in the financial press regarding the spillover of housing into the broader economy — that is indeed a significant risk to monitor. The biggest risk in 2008 is more systemic in nature and is related to market liquidity. Importantly, there is very little way to hedge against illiquidity.

Nielsen: $1.2 trillion of insured municipal securities will suffer a rating downgrade when the mono-line insurance companies are downgraded; the federal government not responding to the credit crisis; single-family housing starts of 700,000, down from a high of 1.4 million. Commercial real estate starts will follow housing starts as well as remodeling products and services. Auto sales will continue to follow housing starts.

■ **Will there be a higher level of M&A activity in 2008? What kind of increase or decrease will we see in deal count and transaction dollar volume?**

Mayer: Overall transaction dollar volume may decline slightly in 2008 due to an absence of the mega-deals that occurred over the past few years. However, middle market deal volume may actually experience an uptick. Right now, our backlog of transactions is at a historic high point. We attribute that to companies wanting to do a deal in 2008 while valuations are still attractive and hedging their bets against a prolonged market downturn. Many business owners are worried about an increase in the capital gains rate after the next election.

Nielsen: We believe there will be a higher level of M&A activity for the privately held middle market companies of approximately 5 percent in 2008. Deal value for privately held middle market companies is expected to increase from $37 million in 2007 to $41 million in 2008.

■ **Will access to capital be tougher or easier by the summer of 2008?**

Franson: It will continue to be more difficult than the "go-go" markets of 2003 through the midpoint of 2007. There is still substantial capital available from private equity funds, with almost $300 billion raised in 2007 alone. Depending upon what assumptions you use for leverage, one can build a case for well over $1.5 trillion of buying power on the sidelines waiting to be invested by the private equity firms.

Seefried: It is more likely that access to credit will be easier. Many of the problems facing the market today are relatively new to the participants; more information and experience will reduce discomfort. Also, much of the "credit crunch" tightness is related to supply overhang — too much debt product trying to squeeze into a now-constricted market.

■ **As credit got squeezed in 2007, strategic buyers were catching up with financial buyers, who had been winning out thanks to access to cheap money. How will this evolve in 2008?**

Franson: 2008 will be a more level playing field for strategic and financial buyers. Debt multiples in the double digits with unlimited capital will not be available to the financial buyers, and this will have a moderate dampening effect on valuation multiples from unprecedented levels. This change will make the strategic buyers more competitive as they have been in the past, as they have strategic reasons for acquisitions beyond cheap capital.

Mayer: Both financial and strategic buyers will be active in 2008. In particular, international strategics will continue to increase their presence due to foreign companies' desire to get a foothold in the U.S. and the weakness of the dollar. For sellers, this is good news since it will increase competition and provide access to a wide variety of different types of buyers.

For full transcripts, see Milstead's blog, Material Disclosures, on RockyMountainNews.com.