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2008 M+A Outlook

Middle-market deals, strategics and digital to play bigger roles.

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To look ahead at M&A prospects for 2008, it makes sense to examine what transpired in 2007. There were several factors last year, and not just the subprime fiasco, that set the stage for what should be a very interesting 2008… Overall, however, the action will be on the middle-market deals until the credit markets settle down.

A Tale of Contrasts

A look back to early 2007 reveals a market in the midst of a feeding frenzy. The year 2006 had closed out at historic levels not seen since 2000 and in their 2007 M&A Report, DeSilva + Phillips said, "The outlook for M&A in 2007 is as good as we've ever seen. All the pieces are in place: Availability of funds, favorable interest rates, eager buyers without the time to build rather than buy, brands that need new delivery platforms."

Now, however, the tone is noticeably subdued. […] But mid-market and smaller deals still got done, and this is where observers are saying the action for 2008 will be—for both strategics and private equity, which may be feeling the pressure to put its capital to work sooner rather than later.

"In the middle market, private equity will support any deal at 5-times EBITDA, fewer deals at 6-times, and very few deals at 7-times," **says Michael Alcamo, president of M.C. Alcamo & Co.** "There is a very substantial amount of capital that was raised in 2002 and 2003, meaning that it has to be put to work before the end of 2008 or 2009. There will be strong motivations to 'get the capital out of the door.'"

"We think the middle market will remain active and will be driven by interactive and marketing services sectors as the Internet continues to transform traditional media sectors," says Scott Peters, managing director at the Jordan Edmiston Group. "Assets that are market leaders with strong fundamentals will continue to trade for premium multiples. High-growth companies will also be in high demand. Deals that rely on heavy leverage will be a challenge given the state of the debt market. That being said, the middle market will remain active and reasonable debt facilities are still achievable."

With the combination of tougher credit facilities and a grim economic forecast this year—the Feds chopped the short-term interest rates by .75 percent at presstime, the largest cut in almost 20 years, more even than the cut after the 9/11 attacks—the focus for buyers may be on properties that are performing at a high level, as Peters notes. Buyer patience for underperforming assets with growth potential may be cut short by the economic outlook.

"High-quality assets that are reasonably priced will continue to trade," says Thomas Kemp, managing director at Veronis Suhler Stevenson. At least one executive, for the very same economic reasons, agrees. "It will be more difficult to sell magazines that are not a leader in their field or that are unprofitable," says Effrem Zimbalist, chairman and CEO of enthusiast publisher Active Interest Media. "A turnaround is much more difficult in a declining economy, and advertisers tend to reduce commitments first to the laggards in the field."

A Strategic Comeback?

With the tight credit market, strategics are smelling opportunity, and are likely to step up last year's already gap-tightening performance against financial buyers. In its annual survey of 1,600 media execs, AdMedia Partners found that 71 percent of respondents believe the economy will be weaker thanks to the housing slowdown, subprime lending fallout and a weakening dollar. In what the report calls a "dramatic shift," 68 percent of respondents indicate that acquisitions by financial buyers will be down in 2008—an about face from the 72 percent who predicted the opposite for 2007. This, conclude the respondents, opens the door for strategic buyers. Mark Edmiston, a partner at AdMedia Partners, agrees: "Activity, generally, will remain at 2007 levels, but with a shift from mostly private equity to more strategic deals. Strategics will be more active because they will not be outpriced by private equity and they need to acquire to grow."

An area that strategics may be particularly interested in this year is digital—especially if they're buying for growth. The DeSilva + Phillips M&A report went so far as to label 2007 "the year of the digital niche acquisition," and it's likely the momentum in that market will continue into 2008.

"The year 2007 was the biggest year by far for watching traditional media using the acquisition tool to acquire digital properties," says the report. Indeed, Penthouse's $500 million acquisition of Various Inc. made the firm's Top 15 deals list. The report also notes that Meredith, Hearst, Hachette, Time Inc., National Geographic Ventures, Wicks Business, Forbes Media, PennWell, MediMedia, WoltersKluwer, IDG and Ziff Davis Enterprises all made digital deals last year.

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