

# Mergers & Acquisitions Report

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## Sellers Eschew Earnouts, Take Lower Price

*California M&A Partner Shares Insights into Current Sell-Side Trends*

Before privately held West Coast Analytical Service Inc. (WCA) agreed to be taken out by a U.K. company, the laboratory services firm turned down another buyer offering a 15% higher purchase price. WCA wanted its fee to be paid in full as close to the deal closing as possible, but the other offer included a longer earnout, recalled Mark Watkins of Sheppard Mullin Richter & Hampton LLP, who advised WCA.

On Jan. 31, Santa Fe Springs, Calif.-based WCA became part of Bodycote International plc's Bodycote Materials Testing unit.

Watkins, who became a partner in Sheppard Mullin's corporate practice group earlier this month, spoke with *Mergers & Acquisitions Report* last Wednesday about M&A trends he has observed during the last several years. Watkins's clients include energy, manufacturing, construction, laboratory testing, transportation and real estate companies. His clients are mostly private middle-market firms with \$15 million to \$150 million in annual revenue.

Watkins said his clients are more cautious about earnouts than in years past. "It used to be that when you had a large component of the purchase

price in an earnout, your eyes would be wide and the potential seller was viewing that as cash in hand," he said. "Now, there's much more skepticism about earnouts and the way they're valued, so you're seeing a lot more deals where the closing consideration is a big selling point." WCA was one example. "There were other opportunities for a greater total purchase price, but [Bodycote] was attractive because it was 100% paid at closing and there was no meaningful earnout."

He attributes this development to clients being more sophisticated about M&A. More M&A process knowledge has also led to clients doing preliminary preparation on their own before hiring legal advisors, Watkins added. "Four or five years ago, you'd get a phone call from a client saying they were interested in selling, then you'd make introductions to various investment bankers and financial advisors, and you'd largely be involved in negotiating letters of intent from the start," Watkins explained. Now, by the time he becomes involved, his seller clients already have drafts of letters of intent and are ready to go, he said.

WCA was one such client. Watkins

said Sheppard Mullin worked for the company for about 20 years before advising it on its sale to Bodycote, and by the time the firm was involved in the deal, WCA was securely entrenched in the M&A process. "They had independent valuations of their business performed and they met with different bankers and advisors—I saw a draft of the letter of intent before it was signed, but they had already pushed it along pretty far," he said.

Energy clients are pursuing M&A in order to cultivate alternative energy sources, he noted. "There is a recognized trend to try to become the company that comes up with the next viable alternative fuel source that's more environmentally friendly and cost-efficient," he said. Watkins currently represents a California energy client with "a very aggressive growth model which involves acquisitions." He declined to offer details. Multiples in the energy industry have increased, and are now six to seven times revenue, he said. "If you land on [a profitable alternative energy source] you've got a home run, so you're going to allocate and pay a little more for assets to play that game."—Joshua Hamerman