

## A Nudge from the Administration

President Obama, in his Feb. 7 speech at the US Chamber of Commerce, challenged companies to invest the estimated \$2 trillion currently in reserves. On top of the \$465 billion PE overhang as tallied by PitchBook, what impact is this available capital having on the corporate growth environment?

President Obama's call for investment is laudable only to the extent that companies are foregoing investments in innovation out of fear. The question that these companies and



**Dale Furtwengler**

private equity firms need to be asking is, "Have we gotten more conservative in our underwriting of innovation?" Absent innovation opportunities, adding jobs will provide a quick burst in economic growth through the release of pent up

demand. It will also fuel the rate of inflation. Neither is good for the long-term strength of the economy.

Indeed, one of the reasons we go through this endless cycle of hiring and downsizing is that, during good economic times when buyers have higher levels of discretionary income, companies get lured into the short-term profit potential that these buyers afford. Or they become enamored with market share. Regardless of the reason, these companies lower their prices to attract buyers who have only a moderate interest in what they offer. At the same time they add infrastructure costs in the form of people and facilities to accommodate the increased demand. To their dismay the next shiny object that comes along or the economy takes a downturn and these buyers go away leaving these companies scrambling to cover the additional infrastructure costs. Ultimately, they have to reduce these costs.

I'd love to do a study of companies that

have gone after market share and measure their profitability for the years between the decision to go after market share and the when they completed their downsizing. I'm certain that they'd have been better off had they foregone the short-term profits, stayed with their ideal market and effected modest 2 percent to 3 percent price increases. Absent investment in innovation, the President's request will produce a similar result to the one I just described.

—Dale Furtwengler, president,  
Furtwengler & Associates, P.C., ACG St. Louis

With these statistics in mind, what impact is this significant available investment capital having on the corporate growth environment?



**Jim Dimitriou**

Corporate America is still squeamish about adding more labor and equipment right now because of the following issues:

1) The current and upcoming regulatory legislation (EPA, Obamacare's 100,000 pages of new regulations and Financial) are strangling businesses. Until these are addressed and loosened, the cash will remain in the coffers of all companies

2) The demand simply isn't there, in all but a few isolated industries (energy and health-care) for increases in output.

The net effect is that corporate America will not grow as much in 2011, but will expand by gobbling up their competition and making strategic acquisitions. This should bode well for M&A activity across the board.

—Jim Dimitriou, managing partner, central region, national practice director, private equity, Tatum LLC, ACG Chicago

Regardless of President Obama's political motives, this situation concerns me. In a recent speech here in Richmond, Chris Williams



**Robert P. Louthan**

of Harris Williams noted that there are over 4,000 private equity firms with greater than \$50 million in committed capital, versus fewer than 200 when he started in the early 90's. Add that to the trillions in corporate coffers, and you have

an imbalance—a bubble—a lot of money seeking a limited number of transactions. To me, that sets up a "good news, bad news" scenario. Good news temporarily for companies seeking capital to grow and expand, but bad news for the hosts of private equity or strategic buyers bidding up the values. The more you pay, the lower the return.

Capital moves to seek the highest return—that was the case over the last fifteen years as money flowed into private equity. Now, I believe the over-abundance of capital

has to self correct. The market is set for a shakeout, a reduction of the number of funds, and the flow of some portion of that capital out of private equity to investments with higher returns. By bidding up the values of investments, the industry is setting itself up for a period of lower returns, longer holding periods, and reduction in size.

Accelerating the investment process will have a short term positive political impact if it happens, but will only accelerate the shakeout I believe is bound to occur.

—Robert P. Louthan, Pelion Financial Group, ACG Richmond

The \$2 trillion on corporate balance sheets and funds available for private equity investment are extraordinary sums that could help jump start the economy if invested wisely. Corporations have three options for these idle funds, return to shareholders as dividends or



Joseph J. Ori

stock repurchases, reinvest in their business or acquire other companies. The best option and one that will benefit the economy the most, is to reinvest the funds back into their own business to become more efficient and productive and to earn a return in excess of their cost of capital.

Companies can also use some of the funds to make acquisitions and if made properly can also be beneficial to the company and the economy. If this \$2 trillion is reinvested or used for acquisitions it would have a very positive effect on economic growth as there would be increased investment in technology, durable goods, people and payrolls, services and increased fees to the various financial service providers such as brokers, advisors, placement agents, lawyers, rating agencies,

etc. There would also be increased activity in the private equity market as more companies will be up for sale, financing or recapitalization. Additionally, the \$2 trillion is sitting on company balance sheets earning a very low rate of return and once those funds are re-deployed and invested, the velocity of these funds will increase exponentially which will be reflected in increased economic growth.

—Joseph J. Ori, CPA, CFA, president and CEO, Paramount Capital Corporation, ACG San Francisco

While the overhang of capital, both with corporate buyers and private equity, makes for a great warchest to do acquisitions, it is not going to fix the underlying issues in the economy. Sure, it can drive growth for acquiring companies, but from an economy perspective, the pie is still the same size — the companies comprising the economy just have different names on



C. Bryan Johnson

their doors. Real economic growth is going to come from the individual consumer—not an overhang of capital. When consumers start earning more and spending more, then we will see true economic growth.

—C. Bryan Johnson, senior vice president, Matrix Capital Markets Group, ACG Richmond

The remarkable amount of cash available for investment has had a quite an impact on the transactional landscape and, in my opinion, will continue to do so over the next few years. The demand for “quality assets” is extremely high, while the supply is still constrained, causing fierce competition for buyers and lenders alike, the impact of which is

already being felt. Corporate buyers, financial sponsors and providers of credit are all feeling the pressure to compete in this marketplace. Purchase multiples for transactions over \$100



Adam S. Cook

million in revenue and \$10 million in Ebitda have not only recovered, but have flourished. Covenant lite credit is available for the same size asset class, with lenders providing air-ball stretch pieces, while pushing leverage coverage ratios.

This market dynamic has caused transaction multiple variances between strategic buyers and financial sponsors to come closer together, leverage on balance sheets to increase as a result of dividend recap and financial sponsor activity and has provided a life line for challenged businesses that could not find credit in 2009. As a result, companies in play during this time may begin to feel the effect in the intermediate term when their cost of capital increases as a result of: higher interest rates, commodity price fluctuation, and other inflationary pressures.

Over the next two years, especially with tax treatment policies expiring at the end of 2012, we should continue to see sellers of quality assets come to market, while challenged and healthy companies should find credit more attainable and attractive. What the future holds beyond 2012 remains to be seen. With credit maturities looming large, the ability to amend and extend hanging in the balance, and uncertain global economic and political landscapes, it could get very interesting. Will US companies be burdened with another layer of debt as a result of the significant investment capital available in today's market? That's a question in need of answering.

—Adam S. Cook, managing director and head of investment banking, Phoenix Capital Resources, ACG New York