MID-STATES CAPITAL
A Private Placement and Business Brokerage Firm
Newsletter

Dear Joseph,

We hope the summer months have treated you nicely thus far! Fall is creeping up on us quickly. In this month's newsletter, we address the importance of three key business metrics, and discuss current market conditions for Middle Market businesses. Please contact us if you have any questions pertaining to this months articles. Also, do not hesitate to contact us if you would like to discuss our service offerings including business financing solutions, buyer/seller representation, and CFO advisory. We would be happy to speak with you!

Best Regards,

Mid-States Capital

Current Market Rates

1 Month LIBOR - .24	6 Month LIBOR - .72
3 Month LIBOR - .44	1 Year LIBOR - 1.04

WSJ Prime - 3.25
Federal Discount Rate - .75

(These rates as of August 21, 2012 according to www.bankrate.com)

Net Income-EBITDA-Free Cash Flow: Key Performance Metrics

NET INCOME is one of the basic measures of the success of a business. Its trend, over time, can also provide a good indication of the direction that the company is headed. In recent years, however,pronouncements by the accounting standard setting bodies, have made it very difficult for any but the most sophisticated financial statement users to understand just what " NET INCOME " represents. This has led to the use of cash flow estimates to assist in understanding the capacity of a business to produce cash for its owners.

EBITDA, or Earnings Before Interest, Taxes, Depreciation and Amortization, has become a prominent metric used by lenders, buyers and sellers to estimate the ability of a business to service debt, support capital expenditures, and distribute earnings to owners.

The easiest way to calculate EBITDA is to take a company's net income andadd back interest, depreciation, amortization and other none cash expense items. Although EBITDA should not be used as the only measure of performance, it is generally a good indicator of the ability to pay down long-term debt. Dividing EBITDA by the cash required for debt payments will yield the debt coverage ratio. Many lenders adjust for anticipated capital expenditures before making this calculation. This is important for companies that are searching for additional financing arrangements because it shows potential lenders that the company will be able to make debt payments in the future.

EBITDA serves as a good measure of profit trends due to the elimination of some of the expenses that are not directly related to operations. EBITDA, like all performance measurements, should be used in conjunction with other metrics because it can give a false sense of profitability. Another good indicator of a company's ability to pay down debt and other expenses is FREE CASH FLOW.

FREE CASH FLOW is the cash that a company has available after all capital expenditures and contractual debt repayment obligations are deducted from operating cash flow. A trend of rising FREE CASH FLOW, is a good indicator that the company has the ability to borrow additional monies to facilitate the growth of the business.

There are many financial measurements that can be taken into consideration when determining the stability and profitability of a company. NET INCOME, EBITDA and FREE CASH FLOW are three important and useful tools to help in that determination.

The Market for Middle Market Businesses

Buyers of middle market companies, those with sales of between $10 Million and $500 Million, are now most commonly an ***Equity Fund***, or one of a very few ***successful entrepreneurial acquirers***, who are continuously buying businesses.

It is a ***Sellers market***. We have a large list of potential buyers frustrated by their inability to locate acquisition candidates. Our transaction size is $2 Million to $50 Million, but we see fewer transactions occurring in this space. The problem? ***Where are the sellers?***

Senior Debt lenders drive the transaction market, and they have yet to return to aggressively financing acquisitions at high multiples of historical EBITDA. We are seeing ***funded debt at 2.5 times EBITDA***, well down from prior to 2009, when multiples of 3.5 times ***EBITDA*** were not unusual. Thus it requires more equity to complete a transaction.

NET INCOME and ***EBITDA*** continue to improve, thus driving up Purchase Prices, but both buyers and sellers are still cautious. Due to the deep recession and anemic recovery in 2008, 2009 and 2010, Earnings and/or EBITDA averaged over the past 3 to 5 years, a calculation used by many buyers, results in an offering price which does not meet the expectations of many business owners.

Selling Price multiples for smaller manufacturing businesses, particularly if they are auto related, are well up from where they were even a year ago. Then we were seeing transactions closed at 3.5 to 4.0 times EBITDA. Today ***4.0 to 5.0*** times is more typical. If a business is only marginally profitable or losing money, prices are determined by liquidation value rather than cash flow multiples.

Mid-States Team

Joseph P. Alam, Chairman

(313) 215-1700
JPA@MidStatesCapital.com

Richard A. Colletta, Managing Director

(313) 300-6480
RColletta@midstatescapital.com

Joseph P. Alam III, Director

(313) 670- 5713
JP3@MidStatesCapital.com

Patrick C. Haffey, Financial Analyst

(248) 444-9213
PCH@MidStatesCapital.com

For more information about Mid-States Capital or our services, please contact Joseph P. Alam at (313) 215-1700 or email JPA@MidStatesCapital.com.

Sincerely,

Mid-States Capital

www.MidStatesCapital.com

JOIN OUR MAILING LIST

MID-STATES CAPITAL LLC
280 Daines Street • Suite 100B • Birmingham, MI 48009
Telephone : (313) 215 - 1700
www.MidStatesCapital.com

Forward email