

Small and Steady: The credit freeze impacting the LBO marketplace has not had the same kind of impact on micro deals according to industry pros

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Sexy they're not, but micro deals, priced around \$25 million or less, continue to attract investors, even as the rest of the deal-making market maintains its in-and-out slumber amid the credit crunch. And while these smaller transactions traditionally fly under the radar, according to pros active in the niche, more investors have indeed started to take notice.

Dwight Jacobs, an executive vice president at boutique advisory firm **GW Equity**, based in Dallas, confirms that he's seen a number of new faces recently that six months ago may have been busier chasing larger deals. "It's the combination of the credit market getting tighter and more people becoming skittish about the economy," he says. "Private equity groups realize that there are good companies and good returns available at this end of the market... and we've found that a lot of larger firms are at least willing to look at deals in this area."

Investors in the space often liken the micro market to the last frontier in the deal universe. It's an area, pros say, where proprietary transactions can more readily be found, but at the same time, companies rarely have the depth of management or the sophistication of larger businesses. To some investors, though, those inefficiencies are exactly what they're searching for.

"It's a tough market to compete in," David Malizia, managing partner of Westshore Capital, tells Mergers & Acquisitions. "But the small market is the last bastion of great returns...You can take a small company, instill better business practices, and really drive growth."

If that growth materializes, and the company can transcend its previous market size, then multiple expansion should also occur on the exit. And Malizia, who launched Westshore in 2006 after a 12-

year run at Florida Capital Partners, notes that the Ebitda growth coupled with multiple expansion, translates into "great" IRRs, the likes of which can rarely be found in other areas of the private equity market.

To be sure, a number of players already exist who are actively pursuing deals in the niche. Malizia's former firm, Florida Capital, for instance, has been active in the space since 1988, while other groups, like Parallel Investment Partners, based in Dallas, and Prospect Partners, in Chicago, are two of the better known names that operate in this corner of the market. Moreover, deals sized \$25 million and under also tend to attract the attention of countless unfunded sponsors or fledgling PE firms that may be operating out of a pledge fund.

One might assume that if larger groups start dipping their toes in this market as well, the niche could become overcrowded. However, that prospect is causing few, if any, sleepless nights. Earl Powell, the founder of Trivest Partners, who's an investor in Malizia's firm, notes that one of the reasons he backed Westshore was because he found the market dynamics appealing. He cites specifically, that the market is "much less competitive and less pricey" than the larger deal realm.

This is partly due to the fact that fewer investors have the patience to deal with the inefficiencies that are customary to the market. But another dynamic is that the universe of companies available in the small end of the market is perhaps larger in number than any other area, and is more than big enough to accommodate the buyers.

Moreover, since valuations in the micro-cap market aren't as influenced by credit conditions, purchase price multiples at this level have not declined to the same extent seen among larger businesses. That means that sellers have yet to be scared off to the sidelines, which at the end of the day - considering how much capital the PE industry has at its disposal - will likely be the determining driver that influences acquisition activity.