Don't Let Having Fun Ruin a Deal

Lessons from 2017's M&A scorecard

Numbers don't lie, but in the case of recent M&A activity, they can mislead. We think that's the case with the scorecard for deals in 2017 that we compiled based on ProSales reporting and my firm's research.

Given that we had just 34 deals in 2017 versus 51 in 2016, you might think buyers have less of an appetite these days. But that doesn't jibe with what we hear. We think there's another reason: You're having too much fun.

Making money—particularly after the housing crash—can easily make you want to stick around and generate even more revenue rather than prep the company for sale. During the M&A panel and amid the breaks at the recent ProSales 100 Conference (see page 32), owners gave signs they wanted to wait two or three years before selling. Good times can do that.

Trouble is, buyers might not feel the same in 2020. And even if they're still buying at that time, valuations have a tendency to drift downward as we get closer to the economy's next soft patch.

You can take comfort in knowing acquisitions continue to be LBM's preferred route for growth. In 2017, the 34 deals we tracked had 313 locations. That's six times as many branches acquired through deals as there were greenfield openings.

Who was buying? In 56% of the deals, it was lumberyards, while another 20% were undertaken by specialty dealers of roofing or drywall. Meanwhile, on the sell side, half of companies sold in 2017 were lumberyards. Another 29% were specialty distributors, typically acquired by a company specializing in the same segment.

After reduced acquisition activity in 2015 and 2016, Kodiak Building Partners came on strong in 2017. The group did three acquisitions in Q4 2017 alone: Drywall Material Sales, American Builders Supply, and Arizona Wholesale Supply. Kodiak also positioned itself for more by taking on growth capital from Court Square Capital Partners. This refueling shows pent-up demand for LBM acquisitions.

As I write this, almost 70 of the ProSales 100 companies had submitted their surveys for inclusion in the ProSales 100. Together, these groups reported an 8% increase in the number of branch locations versus 2016. The majority of these new branches were added through acquisitions by groups such as SRS Distribution and Kodiak. Roughly 60% of deals in 2017 involved the acquisition of a single location.

As for greenfield expansions and closings, in 2017 there were 49 greenfield expansions reported, down from 62 in 2016. This dip in greenfield activity is to be expected at this later stage in the cycle. The number of locations closed has decreased since its recent peak of 58 in 2015 to just 23 branches closed last year. This is an inconsequential number relative to the many thousands of LBM branches that are in business.

Eight states ranked in the top 10 for both the number of branches acquired and the number of greenfield openings.

Buyers indicate that EBITDA multiples for single-location businesses or small to medium-sized companies range from four to six times EBITDA. Strong growth, larger size, unusual profitability, and a good fit with the buyer will push companies to the upper end of that range. The largest deals in the industry are completed at multiples well above the range for smaller businesses. With attractive multiples and strong buyer demand, this is a uniquely appealing time to bring an LBM distributor to market.

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