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MARKETS

Family Businesses Welcome Outside Buyers

Signs emerge that seller’s market is starting to crest

Last year, David Morgan, left, and his co-owners sold their family business to a private-equity-owned rival.
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Growing up, David Morgan couldn’t imagine that the company co-founded by his father four decades ago would one day no longer be in his family—or that he would be the one to sell it.

But after fielding a growing number of calls from interested buyers, Mr. Morgan last year agreed to sell Pac Paper Inc., a Vancouver, Wash., company that specializes in sleeves for coffee cups and employed about 130 people.

Mr. Morgan said he and Pac Paper's longtime co-owners agreed to a sale after realizing the next generation wasn't likely to take over the company—and that good offers may not stay on the table forever. A sale "was the best way to keep family unity," in the future, he said.

The Morgans and their partners sold Pac Paper to a rival then owned by private-equity firm Kohlberg & Co. The price wasn't disclosed.

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Just as corporate mergers and acquisitions are booming, the market for family-owned businesses has been sizzling. For more than a year, sellers have enjoyed the upper hand in negotiating price and other terms, bankers who specialize in such deals said. Especially following a period of belt-tightening during the financial crisis, the climate has spurred many family-owned businesses to explore sales with fresh urgency.

Now, there are signs the market could be "cresting," said Andrew Greenberg, chief executive of GF Data Resources LLC, which gathers information on small private-equity deals. Companies are selling to private-equity firms at lower multiples of earnings, and valuations could flatten more if interest rates rise as expected in coming months, he said.

J.B. Pritzker, who co-founded Chicago investment firm Pritzker Group with his brother Tony, has in recent years bought a number of companies owned by families or entrepreneurs. But he said he has of late been put off by some of the deals available, saying it has been a sustained "seller's market."

Bankers say they have been advising closely held businesses to consider selling before the market turns. "There's no chance of valuations getting better," said Christian Schiller, a managing director at Cascadia Capital LLC, a boutique advisory firm that advised the Pac Paper sellers.

The uncertain outlook only complicates the decision making for family-owned firms. Families are often driven by motivations such as taxes and succession that don't typically apply to corporations.

For the Morgan family, there was also the sense that they had expanded the business all they could through the recession and "risked becoming stagnant," Mr. Morgan said.

Compared to multibillion-dollar corporations, most family-owned businesses are relatively small, with deals ranging between $10 million to $1 billion.

Although there are no data that tracks deals struck by such companies, the number of transactions between $25 million and $100 million has increased from 592 in the first quarter of 2012 to 782 in the second quarter of 2015, according to data compiled by Pitchbook.

A potential sale of Belk Inc., a family-owned department store, for more than $3 billion would be among this year's largest such deals. Belk said in April it had hired Goldman Sachs Group Inc. to explore options such as a sale.

Sales of family-owned firms are contributing to this year's record deal activity. Global deals valued at roughly $3 trillion have been announced this year, according to Dealogic, on pace to hit the highest level on record. If the current torrid pace continues, takeover deals would exceed the $4.3 trillion of deals notched in 2007, the last year before the financial crisis and recession that caused deal making to dry up.

While the broader economy is patchy, companies of all sizes are sitting on piles of cash after a period of cutting costs during the recession. Low interest rates have also made borrowing attractive. Acquisitions, then, are often the easiest path to growth.

From a buyer's standpoint, family-owned businesses are attractive targets because they usually carry less debt, are run conservatively and have low employee turnover, bankers say. That has created more competition for well-run businesses.

"At some point the rising valuations really compel private business owners [to decide] if they should be holding forever or should they monetize," said Steve Faulkner, head of private business advisory at J.P. Morgan Chase & Co.'s private bank.

Mr. Faulkner said J.P. Morgan's private bank had twice as many conversations with clients about selling their companies in 2014, compared with 2013. This year, the number is already up 35% from 2014, though it is unclear how many conversations lead to an eventual sale.

Wells Fargo & Co. doubled the size of its middle-market M&A pipeline representing sellers from 2013 to 2014 and business continues to grow, said Sam Farnham, who heads that unit for the bank.

Since the financial crisis, families increasingly are looking to diversify their assets rather than having their entire wealth invested in one business, according to family-business experts. Another motivator is taxes: With presidential elections less than 18 months away, many families are concerned capital-gains taxes could go up soon, leaving them with a heftier bill on profits from any sale.

For companies that have been in families for many generations, there is a growing fear that technology or dramatic shifts in their industry could overtake them. A lot of families are "waking up to the idea that businesses can become obsolete very fast," said Rich Simmonds of the Pacific Family Business Institute.

The third-generation descendants of William Henry Belk, who founded the Southern department store chain in 1888, are exploring a sale partly in response to a "rapidly changing" retail industry, a spokeswoman said.

Still, some family owners who have pursued deals this year have changed their minds. Ashley Furniture Industries Inc. was working with an investment bank earlier this year on a potential sale, The Wall Street Journal has reported. The family-owned Wisconsin furniture maker later decided to pull its process, and received a standing ovation from employees at the company when it announced its decision not to sell.

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