MID-ATLANTIC

Mid-Atlantic deal activity could pick up in the first half of the year, sources say

Mid-Atlantic businesses may see increases in M&A, IPOs, and strategic investments in the first half of 2014, industry experts said.

The region is likely to see more defense and aerospace-focused transactions, as strategic buyers look for emerging businesses with innovative technology, although government services businesses will continue to see declining federal budgets impact their growth potential. Nevertheless, a two-year federal budget agreement is likely to create some stability in 2014, sources said.

Energy sector IPOs are likely to increase from private, upstream companies with positions in the region's Marcellus and Utica natural gas fields. Midstream companies operating in those fields are likely to see more strategic and private equity investments, one industry source said. Manufacturing and distribution businesses in Maryland and Northern Virginia could see buyouts, said a Baltimore-based private equity professional. Deals involving building products and services companies could also increase, he said.

"There will be more deal activity over the next six months," said Michael Langman, a managing director at Virginia-based The McLean Group. There is a "tremendous" amount of activity in the lower middle-market, especially in the sub-US$100m in revenue space, which comprises many innovative, entrepreneurial companies, Langman said. Although there are many defense and aerospace businesses in the Mid-Atlantic, the industry is global, he said.

Acquisitions are attractive to large buyers because they can "pick the winners," Langman said. Buyers will likely prefer M&A to internal research and development because technology, program and market risks tend to be reduced. Deals in defense and aerospace will happen "across the board," and not just in hot areas such as Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance (C4ISR), unmanned aerial vehicle (UAV), and Cyber, said Langman. Buyers have plenty of cash and they will need to decide where to compete, amid declining defense budgets, he said.

Kevin DeSanto, managing director of Washington, DC-based KippsDeSanto & Co., said he believes there is going to be an increase in M&A in aerospace, defense and government services in 2014. In part, that increase will be related to a two-year federal budget agreement which is expected to create stability in those markets. Recently many buyers in those industries have experienced strong stock performances driven by the broader market, so M&A may have been less of a focus, he said. As of late, many of those companies have also focused on internal restructuring, such as management changes and share buybacks, DeSanto said. Strategic buyers cannot stand still forever, he noted, explaining that he sees no lack of interest in M&A at KippsDeSanto.

A Virginia-based aerospace analyst, said there has been recent speculation regarding potential consolidation among the prime defense firms because of federal budget pressures. Nevertheless, a deal is certainly not "imminent," he said. It's "conceivable" that Northrop Grumman or Raytheon could be in play, he said.

Manuj Nikhanj, managing director, head of energy research at ITG Investment Research, said there are likely to be more IPOs of private companies with exposure to the Utica and Marcellus gas fields in the first half of 2014. There is less likely to be large corporate M&A or major land package sales, he said. Nevertheless, Dominion Resources may sell some of its acreage in West Virginia and Talisman may sell some of its Marcellus land, he said. If there was a large corporate deal, it would likely be a "super major" or a large international company buying an operator with 100,000 or more net acres in Northeast Pennsylvania, Southwest Pennsylvania, or in the southern Utica, he said. Midstream players throughout the region will likely see major capital investments, because lack of midstream infrastructure is the main constraining factor for upstream operations, Nikhanj said. Investments from private equity and large pipeline companies will increase now that there is less uncertainty about the region's gas resource and its quality, he said.

Thomas Neale, managing partner at Baltimore-based Patriot Capital, said he sees investment activity "absolutely picking up" because businesses "no longer think things are going to fall off a cliff." Patriot, a minority stake and subordinated debt fund, invests nationally, Neale said. When asked specifically about Mid-Atlantic investment activity, Neale said, there could be some deals in manufacturing and distribution in Maryland and Northern Virginia. He said he also heard from a Richmond, Virginia-based M&A professional that activity in building products and services is ramping up, which is a great indicator that the housing market is improving. Biotech in the region may also be active for deals, he said. Private equity firms seeking to invest in companies with up to US$25m in cash flow will be looking at a seller's market. There is about US$ 250bn in cash chasing those size deals, Neale said.

by Benjamin Koconis