BUNDY GROUP
MERGERS & ACQUISITIONS · CAPITAL RAISES

2020: The Year Ahead for Mergers & Acquisitions

Key Takeaways

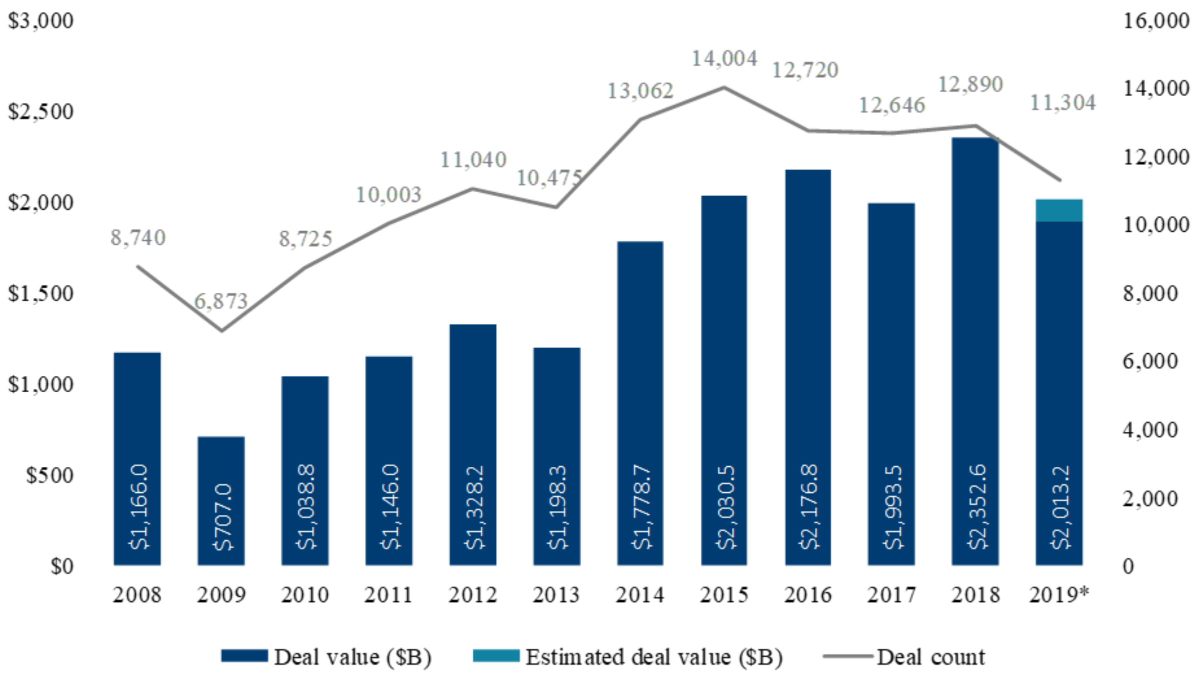
With rumors of a down market constantly circulating, business owners are asking several key questions in order to determine their next steps in the 2020 Mergers & Acquisitions environment:

- Have I missed the window on selling my business for this M&A cycle?
- If I do consider a full or partial sale now and want to obtain a strong valuation, what do I need to do before and during buyer discussions?
- What industries are buyers most attracted to today?

Background

After the Great Recession years of 2008 - 2009, North America witnessed a steadily improving Mergers & Acquisitions market. By 2014, the economic recovery had kicked into full gear, and the volume of Mergers & Acquisitions ("M&A") activity significantly increased. While the 2019 M&A market experienced a drop off relative to the phenomenal 2018 market, the end result continues to be one of the most fertile markets in recent history for business owners to complete a full or partial exit from their companies.

North America Mergers & Acquisitions Activity (2008 – 2019)



Source: PitchBook North American M&A Report (2019)

2020 Insights and Updates

Have I missed the window for selling my company?

The short answer is no....but timing may be short for businesses in industries that have heavy exposure to economic swings and consumer discretionary spending. As an example, when the housing market collapsed in the Great Recession, companies in a variety of industries suffered, including construction, building products, mortgage finance, and retail. It is difficult to project what will cause the next economic downturn and which industries will bear the brunt of that downturn. Therefore, owners should constantly evaluate macroeconomic trends and how those changes impact a company's specific industry. If, as an owner, you think your company's exposure to economic shifts is high, then you may want to 1) explore ways to build more recession resiliency into the products and / or services you offer clients through diversification 2) consider starting a business sale process sooner rather than later.

How do owners obtain a strong valuation in the late stages of a Mergers & Acquisitions cycle?

With over $1.45 trillion in unused private equity capital and both public and private companies sitting on healthy piles of cash, there remains a tremendous amount of well-capitalized buyer options for owners to consider.[(1)] However, in a late stage economic cycle, most of these buyers are wary of paying strong valuations for companies that could experience a drop-off in performance should North America and / or international markets enter a recession. Therefore, strategic and private equity buyers will go through an extensive diligence process when pursuing an acquisition target with the end goals of minimizing risk and often looking for ways to obtain the business at a discount to market value. These diligence processes often exhaust a seller's patience.

To obtain a strong valuation, expedite a due diligence process and increase the "certainty to close" in a transaction, owners can take a few important steps:

- **Demonstrate stability of company performance**, including how the company will continue to perform in an economic recession. That could include highlighting the depth of the company's contractually-driven backlog, the recurring revenue that a company generates, and the company's strategy for minimizing the impact economic swings may have on the business.
- **Complete a thorough financial analysis** of historical and projected financials by working with an independent accounting team experienced in M&A. Understanding where "the good, the bad and the ugly" reside in the company's financials, coupled with a clear articulation of company growth strategy through a well thought out financial projection model, helps a seller to minimize the risk of a buyer adjusting down the company's EBITDA, which could decrease the transaction value or cause the deal to fall apart.
- **Ensure the seller maintains negotiating leverage** by introducing competition to the process. If a strategic (i.e. industry) or private equity buyer feels confident that they are the only one in discussions with the seller, then the buyer will have much less incentive to "put its best foot forward" through an offer to purchase and to close the deal quickly.
- **Highlight to strategic buyers any potential synergies** between the strategic buyer's operations and the selling company. Examples could include new revenue generated, or lower material purchasing costs realized, as a result of the combination of two companies. If an owner is focused on selling to a private equity group and allowing the company to serve as a new platform investment, one key positioning point is highlighting the accelerated organization growth that can be realized utilizing the resources of a new, well-capitalized private equity partner.

EBITDA = Earnings Before Interest Expense, Taxes, Depreciation and Amortization

Which industries are attracting significant amounts of buyer interest?

We are in an age of industry specialization as it pertains to investment bankers / M&A intermediaries, private equity groups, and strategic buyers. Many of these players are spending more time focused on fewer industry verticals, which then helps these groups to gain more traction with M&A opportunities. For every industry, there is a host of both strategic and private equity buyers looking to grow and invest through acquisitions. That being said, there are some industries that are more attractive to the collective pool of buyers than others.

Why are some more attractive than others? There are many reasons, but buyers will focus on key fundamentals such as industry stability, profitability of companies in the segment, and growth opportunities, both as a market and for the companies within that market. If a business resides in an attractive industry, then it will be reflected in quality and quantity of buyer candidates as well as the valuation potential for the company.

Examples of attractive industries include:

- **Healthcare**: The aging baby boomer population, and the rapidly changing dynamics in the industry (examples: migration to value-based care, increased utilization of outpatient centers, growing adoption of technology and analytics in healthcare), are driving enormous consumer demand for healthcare services and products. Strategic and private equity buyers have taken note. The corresponding M&A activity can be felt in sub-segments such as dermatology, orthopedics, podiatry, pharmaceutical services, and healthcare technology. As an example, in 2011 there was only one private equity investor in the dermatology market, yet by 2018 there were over 30 private equity groups active in the segment.[2] Buyers generally view the healthcare market as a large, recession resilient and attractive segment that is ripe for continued investment and consolidation.

- **Controls & Automation / Internet of Things (IoT)**: The market of software, hardware, and system integration providers centered around controls & automation capabilities has witnessed a significant increase in Mergers & Acquisitions activity over the past decade. Buyers recognize the vast market potential, as the global industrial automation market is expected to reach $352 billion in 2024 relative to a 2015 market size of $183 billion (i.e. a 6.6% compounded annual growth rate).[3] With the emergence of the Internet of Things (IoT) subsegment, and the growth of the overall controls & automation market, the pace of strategic and private equity activity is expected to further accelerate.
- **Cybersecurity**: There is a need for over "one million new cyber warriors" to effectively address challenges faced in terms of technology security for companies and governments.[4] Furthermore, and in a nod to proprietary software firms, "detection and monitoring software are trying to pick up the slack from these missing humans by leveraging machine learning."[4] Cybersecurity markets globally are projected to reach $6 billion in 2022 from a market size of $3 billion in 2017, which represents 14.3% in a compounded annual growth rate for the market.[5] For these reasons, cybersecurity services and software firms active in the market today are highly coveted by both strategic and private equity buyers, and the valuation multiples for such transactions reflect this extreme buyer demand.
- **Water & Wastewater**: The U.S. Water & Wastewater market, approximately $743.7 billion market in 2019, is anticipated to grow to $914.9 billion by 2023.[6][7] Companies that service this segment, whether it be technology, service or manufacturing providers, are addressing a massive market that demands improved water management without sacrificing quality or supply. Seasoned private equity and strategic buyers see this as a very recessionary resilient sector that will remain stable and growing for many years to come.
- **Software as a Service**: Famed venture capitalist Marc Andreessen has been quoted as saying "software is eating the world."[8] We are in a business world where companies are leveraging software to increase sales, improve tracking of assets, and find ways to gain efficiencies. Businesses that have developed and commercialized software products, and provide accompanying technology services, will likely generate a great deal of interest from a buyers market that places a premium on such companies.

Conclusion

The attractiveness of a company to strategic and private equity buyer candidates depends on many factors. In an ever changing global economy, which can face pressures from shocks ranging from tariffs to the impact of coronavirus on international supply chains, owners should be wary of tipping points that could negatively impact the M&A market. As it relates to the current state of the Mergers & Acquisitions market in 2020, the right foundation is still in place for owners to sell today. In order to maximize exit options for owners, every effort should be made to focus on strategic planning, growth and value maximization activities. By doing so, owners will ensure more attractive exit opportunities if or when that day arrives.

About Bundy Group

Bundy Group is a boutique investment bank with offices in Charlotte, New York and Roanoke. The company specializes in representing business owners and management teams in business sales, acquisitions, and capital raises. The 30-year-old firm has closed over 200 transactions across a broad range of industries.

Sources

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