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The Impact of COVID-19 on the M&A Market

By: Doug Robbins

Past Issues

The COVID-19 pandemic put a halt or delay to almost all M&A transactions earlier this year. We're about to enter the 10th month since the pandemic was declared and shutdowns started to occur in many jurisdictions. The future is still uncertain with no clear path forward.

Buyers have not stopped looking, but they are extremely cautious. Due diligence has become extended and quality earnings analysis seem to take next to forever. Banks are slow to approve financing requests.

Every 4 years, the US election causes both buyers and sellers to pause to see who wins and what impact that may have on their businesses, but once the president is sworn in in late January, things start to pick up. As a result, many prospective sellers are on hold, waiting for some sense of the future.

We are starting to see some activity from sellers, but since most businesses have been negatively impacted by the economic realities of the pandemic, along with the economic uncertainties of the US election, they are hesitant to proceed, for fear that they will be facing a reduction in the value of their business.

At Robbinex®, we fully expect many more businesses will contemplate going to market in the 2nd quarter of 2021, and we have added 6 new employees to deal with this anticipated increased activity.

The real question is, how do sellers and buyers, along with their advisors find the common ground to navigate these uncharted waters?

Since the true value of any business lies in its ability to earn profits in the future, we believe that business owners and their advisors are going to find ways to adapt to the economic uncertainty and will create unique strategies and transaction structures to mitigate/quantify the risks of economic uncertainty from COVID in order to move forward with a transaction.

At its core, a large part of the volatility and uncertainty we are experiencing due to COVID simply leads us back to the fundamental question of how to effectively manage and quantify the risks of an acquisition.

Valuation is often derived by valuing the future cash flow of the company and discounting it to present value. The expected cash flows have factored the associated risk to the cash flow stream by assessing all known and unknown risks and the potential events that could impact the return of capital to business acquirers. Within this model, COVID is simply another risk that must enter the equation.

During the preceding years of an expanding economy and general bull market, along with sellers enjoying a healthier, longer life expectancy has resulted in fewer businesses being available to purchase, resulting in a steady increase in purchase prices paid for companies.

Interest rates dropped dramatically and buyers – both strategic and financial – had access to an abundance of excess capital to invest. Private equity groups have been eager to deploy capital into equities with the return on debt being historically low. Buyers were willing to pay for growth with higher valuations rather than building it organically.

The daily inquiries from search funds, corporations, high net-worth individuals, and private equity groups looking for acquisition opportunities has not stopped throughout the pandemic.

However, there is a slight shift from "Do you have anything?" to "Do you have anything that is profitable now during the pandemic?"

As buyers narrow their focus and screen for better deals, they will filter out more potential transactions or make valuation adjustments to protect their downside risk. This downside protection will come in the form of:

- walking away from potential deals
- greater scrutiny of business opportunities, with greater emphasis on due diligence and quality of earnings
- a decrease in the price offered or
- an adjustment in terms to mitigate the risk
- a strong trend to more deferred payment terms with the payment contingent on future results/earnings

Today's World

Due diligence has increased to understand these risks and the impacts of the related uncertainty. Traditional company specific risks like the seller's involvement in the business, customer concentration, inconsistent revenue streams, supply chain issues and supply chain concentration, and other factors will have to be thoroughly understood or sellers will face significantly decreased valuations and less favorable terms as a result of the uncertainty of the pandemic's continued impact on the economy.

Completing Transactions in Today's Environment

We appear to be transitioning from a seller's market to a buyer's market. If that turns out to be true, then sellers will need to be more flexible and creative in how they allocate the potential risk of a transaction, in terms of seller differed payment programs. Sellers will also have to ensure that processes, systems, employees, suppliers, customers and financial records are in order to ensure that the business will pass the scrutiny of a significantly intense due diligence process. Many sellers will choose to wait for more favorable conditions.

The good news is that conditions are still ripe for acquisitions to be completed. Buyers have huge amounts of capital to invest, along with access to low-interest debt. There is a strong desire to deploy capital into acquiring operating businesses, because the return is much higher than interest rates. Strategic and synergistic buyers will look for transactions that enable them to add market share, create synergies, acquire locations, equipment, or add new products, service, or additional employees.

Bottom Line

Today, getting a mutually beneficial transaction completed boils down to understanding the uncertainty of COVID's continuing economic risk and allocating that risk in a manner that is satisfactory to the parties involved.

About the Author

Doug Robbins, President and Founder of Robbinex Inc.

Doug is an internationally renowned Canadian Business Intermediary and Business Broker. He is a seasoned businessman having completed more than 1,000 assignments relating to advising clients on Mergers and Acquisitions (M&A); valuations; transferring businesses to the next generation; partnership resolutions; refinancing; along with numerous other consulting activities.

Doug has always actively supported the M&A profession through investing significant time and energy by way of memberships, lecturing, and presenting workshops for numerous M&A organizations.

The Robbinex Mission

To assist clients who are considering transition to make

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…the **right** time for
…the **right** reasons™

by providing experience-based knowledge

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