

# MARKET INSIGHTS:

## The case for M&A during COVID:

### Lessons from the mid-market frontlines in North America

Q2 - 2020



The Covid-19 pandemic has thrown the world into unprecedented crisis. The IMF predicts that real GDP will contract by 7.6% in 2020 globally.<sup>1</sup> This steep slowdown has unsurprisingly affected deal making across the globe. In early July, Pitchbook reported a 20% drop in deal value in PE-led deals in the US in the first half of 2020<sup>2</sup>, which is consistent with the similarly eye-catching 39% year-over-year drop in global deal value reported by Mergermarket.<sup>3</sup>

What is in store for the second half of the year for deal-making? This *Market Insights* looks back at the financial crisis of 2008 for clues and compiles insights from our own M&A Advisory team—which has been extremely active and adapting to rapidly changing conditions since early March.

**“HISTORY DOES NOT REPEAT BUT IT DOES RHYME” – Mark Twain**

One can look back at recent crises of similar magnitude for similarities, differences and lessons learnt. It goes without saying, the nature of the current turmoil is starkly different to that of the 2008 financial crisis, but there are relevant parallels.

Firstly, companies that made significant acquisitions during the previous downturn outperformed those that did not. Between 2007 through to 2010, active acquirers enjoyed total shareholder return (TSR) of 10.5% vs. 3.3% for less active companies.<sup>4</sup> Deal-makers know this at a visceral level—the numbers underpin that, and that observation should be top of mind for corporate development teams and private equity firms today.

Secondly, three trends (see graphs) from the past 20 years<sup>4</sup> of M&A activity may educate the shape of the recovery for deal-making:

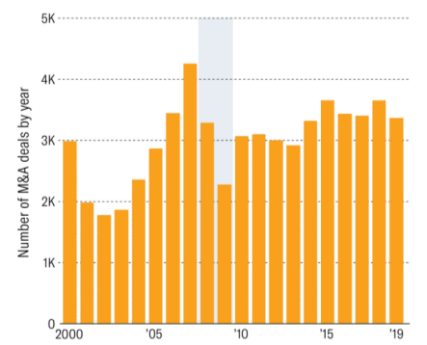
	2000-2001 Dot-Com Crash	2008-2009 Financial Crisis
Deal Volumes	U-Shape	Square Root-Shape
Total Deal Value	V-Shape	U-Shape
Deal Multiples	U-Shape	Square-Root-Shape

These shapes suggest the window for M&A at attractive multiples relative to long-term averages can close quickly. Those with the liquidity and the risk tolerance to move quickly, and who have done their homework in advance, have history on their side.

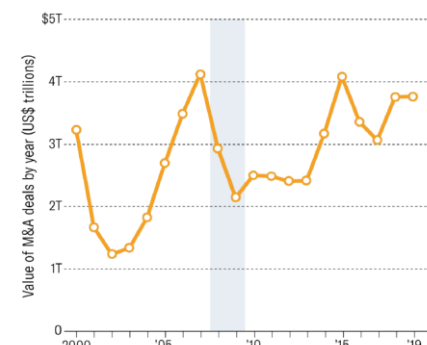
Larry Fink, the CEO of BlackRock, holds the same view, in an email to his staff on April 14, 2020: *“We are being opportunistic and buying during this time. I have no idea if we’ve hit bottom yet, but I do know where valuations are over a long horizon, where credit valuations are over a long horizon... there are good opportunities out there... and if you don’t have leverage, this is the time to start adding risk, not running away.”*<sup>5</sup>

In early April as well, consistent with the above, a survey of 93 private equity firms<sup>6</sup> by data provider SourceScrub reported that 32% of firms anticipated being more aggressive in their use of capital in the coming months. 73% of them also believed that the window of opportunity to close deals will have re-opened wide in the second half of 2020, though they all acknowledged that the nature of deals will not be traditional buy-outs, but rather add-ons, PIPEs, carveouts, distressed-for-control transactions. Lastly, most have put plans for exits on hold as firms have seen steep markdowns in their portfolios and are choosing to hold rather than liquidate at sale prices.<sup>2</sup>

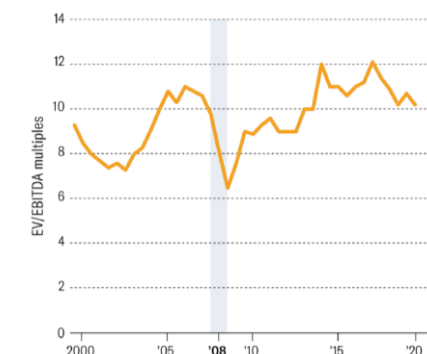
**Volumes**



**Total Value**



**Valuations**



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#### NEW PLAYERS, WITH CIRCUMSTANCIAL MOTIVATIONS

Since the beginning of March, FirePower Capital's M&A Advisory practice has been engaged on nearly as many buy-side mandates as it had in the five years ending in February 2020. Set aside the obvious commercial bias in inserting this statistic—the point is that acquirers are on the move, as they know that there are unusually priced opportunities available and want to leave no stones unturned. The level of pursuit is high (see *live case study inset*).

In the process of this heavy outreach activity, our team has encountered three new kinds of actors, since the pandemic started:

- The “*empathetic, yet keenly opportunistic*” buyer, which will go to great lengths to represent they have good intentions (and in many times they do) but will insist on sellers stomaching COVID-related discounts or heavily contingent structures. They may also only consider distressed situations. We caution against that narrow view from a buyer's perspective, in that it may cause those buyers to pass on good transactions. At the end of the day, there are no bargains for good companies. The take-away is for buyers to pay extra attention to sellers' expectations—more than ever before, finding creative means to bridge gaps is key;
- The “*I've had enough of this, this is too hard on my own*” owner-operators of tightly held businesses, most of them baby boomers, who thought they had another 5 years or so in them, but have (at least temporarily) thrown in the towel and are considering bringing in a partner or exiting entirely. Some of these owners are at the helm of solid businesses—they are not necessarily distressed; what unites them is the unwillingness to rebuild. A respectful and sympathetic approach goes a long way to getting a deal done with this kind of seller; and,
- The “*Thanks for reaching out but talk to me when this is over*” seller, who knows an exit is overdue but who doesn't have the bandwidth to address the strategic imperative—they are merely trying to survive this pandemic. They are willing to hear out buyers and their plans, but they are not truly listening. It may seem futile now but building relationships with this kind of seller should pay off in the mid-term: it's important to be there when they will be ready.

Our M&A Advisory team is recommending buyers adjust and accelerate their M&A strategies: revisit sectors of interest and target lists, initiate conversations, and keenly listen to issues and expectations.

#### Live case study<sup>7</sup>

Days in market: 154

Identified targets: 730


Phone conversations: 276 (38%)

Client-target discussions: 18 (7%)


Offers submitted: 2 (4 more in play)

#### RECENT TRANSACTIONS

JULY 2020




**SUMMIT**  
INTERCONNECT  
Acquired



**ITL**  
CIRCUITS

The undersigned acted as advisor to the seller



JULY 2020

Equity Injection

For




**BATL**

The undersigned is an investor in the company




APRIL 2020




**WAYSIDE**  
TECHNOLOGY GROUP

Acquired



**INTERWORK**

The undersigned sold its majority stake in the company



[1] OECD Economic Outlook, June 2020 <http://www.oecd.org/economic-outlook/june-2020/>

[2] US PE Breakdown, Q2 2020, Pitchbook [https://pitchbook.com/news/reports/q2-2020-us-pe-breakdown?utm\\_campaign=q2-2020-us-pe-breakdown&utm\\_medium=nl-na&utm\\_source=reports](https://pitchbook.com/news/reports/q2-2020-us-pe-breakdown?utm_campaign=q2-2020-us-pe-breakdown&utm_medium=nl-na&utm_source=reports)

[3] Mergermarket Global & Regional M&A Report Q1 2020 <https://www.mergermarket.com/assets/MergermarketFinancialLeagueTableReport.Q12020.pdf>

[4] The Case for M&A in a Downturn – Harvard Business Review <https://hbr.org/2020/05/the-case-for-ma-in-a-downturn>

[5] Excerpts from Larry Fink's Market Briefing (in email, April 16, 2020).

[6] “How is COVID-19 Impacting Private Equity and Venture Capital?” SourceScrub survey

[7] FirePower Capital data