

M&A Outlook: How Will the Pandemic Play a Role?

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(NOTE: Partner [Paul G. Mattaini](#) was interviewed in August 2020 by the Central Penn Business Journal for an article about the outlook for mergers and acquisitions in its annual *M&A in the Midstate* supplement. Here is a transcript of the full interview for Paul's thoughts on what a pandemic M&A world might look like in both the near term and longer term.)

Q: What was happening with M&A activity this year before the pandemic and then what happened during the height of it, and what is the status now?

A: Before the pandemic, the M&A market was fairly active and would probably have been classified as a "seller's market," where the market terms were favorable to sellers, including pricing terms. Almost all M&A transactions at least paused at the height of the pandemic. At this point, some transactions are proceeding, some are being "slow-walked," others have been deferred and, finally, others have died.

Q: How do you see 2020 shaking out by the end of this year? In other words, what are the special risks or benefits with M&A now?

A: I think that transactions can definitely continue to be done during 2020, assuming that the business to be acquired is performing reasonably well and the outlook of the industry is acceptable. Perhaps the biggest risk would be another shutdown of the economy, particularly if the seller's industry is affected disproportionately.

Q: What do you think will happen in 2021?

A: I think that there is a chance that the M&A market in 2021 could rebound a bit from the current level of activity, although perhaps not quite to pre-pandemic levels. There are a number of factors that could add to the uncertainty. Obviously the state of the pandemic will be a factor. Other factors will include the outcome of the presidential election and, perhaps most importantly, the willingness of banks to lend to support transactions. It will be interesting to see if the market will start to trend toward a "buyer's market."

Q: What industries are seeing the most activity and why?

A: In terms of industries, there are probably two answers. Industries that are doing well, such as agriculture, will likely be the most active. On the other hand, in industries that are under pressure - hospitality comes to mind - there may be opportunities for "distressed M&A." In the latter case, while there are opportunities, the buyer needs to address the risks that caused the distress for the seller.

Q: Is certain activity increasing or decreasing because of concerns of a long slowdown?

A: It will be interesting to see how the current situation will impact M&A in the banking industry. Currently, it might be difficult for a buyer to conduct due diligence on a selling bank's loan portfolio. However, like other industries, a time of stress could lead to opportunities in the medium term.

Q: What is the situation with valuations? How are they changing and why?

A: Valuations might be the most interesting topic right now. For example, will the buyer?

- Ignore 2020 financial measures and look only at pre-2020 numbers;
- Try to factor in specific "addbacks" that affected 2020 numbers;
- Require sellers to ramp back up to pre-pandemic levels before closing on a transaction; and/or
- Use earnouts tied to pre-pandemic levels to provide sellers with the opportunity to receive "full prices."

Also, if banks lend at lower cash flow multiples, prices will be negatively affected unless buyers are willing to put more equity into transactions.

Q: Are some people deciding to wait until after a vaccine is found for the virus, or are they waiting until the economy otherwise settles down?

A: In terms of buyers, some potential buyers will have their attention diverted by their own issues or issues of their portfolio companies. However, in most cases, buyers will respond to opportunities and, in the case of private equity firms, buying companies is an important part of their business. In fact, some buyers will emerge from this period as "stronger buyers."

In the case of sellers, it is possible that some companies that would otherwise be sellers will choose to hold off on a transaction until the M&A market stabilizes/improves. Some other owners will likely become sellers as the recent circumstances has caused them to be "tired out." Some owners will be unable to become immediate sellers due to the performance of their businesses, the need to ramp back up and/or the outlook of their industries. In that case, it is still important for such owners to prepare for an eventual exit. As is always the case when the M&A market cools, some sellers will stand out and likely be in a position to execute a favorable transaction, particularly if there remains a significant demand for transactions by buyers.

Q: What is the situation with health care?

A: I think an interesting area to watch will be the continuing care retirement community sector. There is obviously a great amount of demand in that area but, at the same time, there are significant challenges. We might see some consolidation activity in the CCRC industry.

Q: What's going to be something you'll be watching about the M&A process?

A: With the challenges of in-person interaction, one thing to watch for will be whether buyers can be satisfied with remote, versus in person, due diligence and/or management meetings.

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