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The New M&A (First of a Series)

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This week we kick off a new series on COVID-impacted deal flow, with a look “upriver.” How has M&A activity been affected, and what should deal makers expect for the “new normal?” We spoke to select middle market investment banks about their experiences so far in this coronavirus season.

The beginning of the crisis caught advisory firms (and the rest of us) flat-footed. “Of the deals we had in the shop when the music stopped in early March, roughly 80% were put on hold,” one partner told us.

Another sell-side MD agreed. “Things came to a screeching halt,” he said. “We adjusted our expectations to 20% of normal in the early days. It’s climbed back up, and we’re seeing a good amount of activity, but it’s still half of what it was.

“We’ve still managed to sign up twenty or so deals since March,” he went on. “Not all of them have closed. But most of these assets have performed, particularly in the tech sector, healthcare and pockets of consumer. Industrials are more of a challenge.”

How about purchase price multiples? “Valuations generally are down about 15% from pre-COVID levels,” a third source reported. “We estimate it will improve next year, bringing prices up to a net 5% decline. These numbers are being impacted by lower ebitda, the negative cash flow drag from higher cost financings, etc.”

“It’s really a tale of two markets,” he continued. “If it’s non-COVID impacted, multiples are at or higher than pre-COVID levels. Essential services remain highly prized and are priced at a premium. Of particular interest for us are companies that grew through the crisis with no budget tweaks.”

What about size of companies. Has that changed? “Ours is a pretty broad middle market mandate,” the first banker said. “Ebitda was in the $10-50 million range. Now that’s bifurcated between much smaller ($5-10 million) companies and those at the higher end of the middle market ($30-50 million).”

The micro-category is popular because it doesn’t require the last turn of leverage to get financed. It’s also easier to diligence in a virtual process. Larger properties are also coming back to market as performance stabilizes.

Bankers generally point to what feels like the next stage of the crisis. “We’re passed the panic point,” one told us. “More interesting is what to expect post-COVID. June has seen the reinstigation of the market. Deal flow now is the ultimate redefinition of what’s ‘good.’

“We’re not in a stasis,” he concluded. “You’re not going back to that. This is about a search for new paradigms.”

? Next week: How has the post-COVID sale process changed?