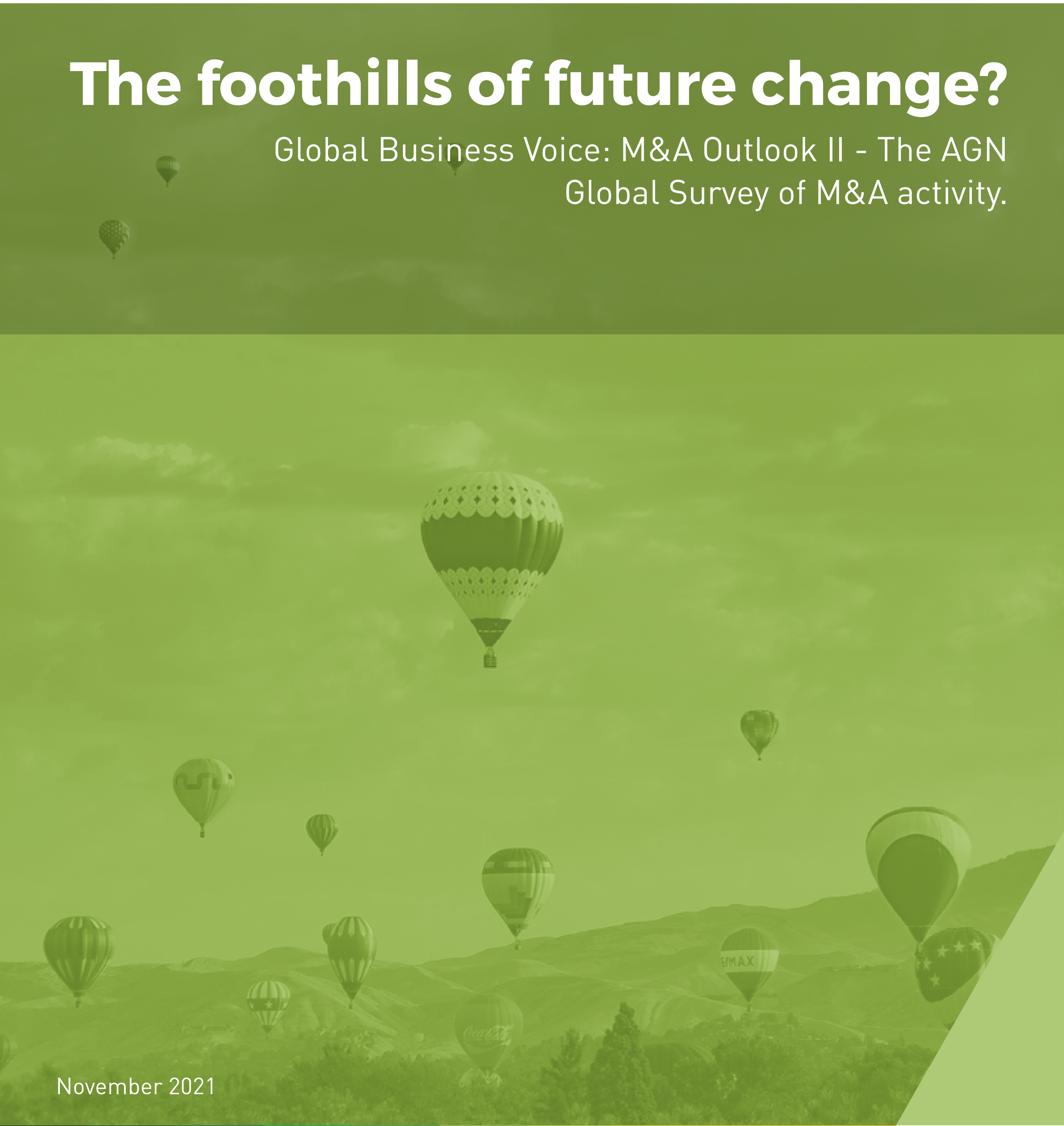
The foothills of future change?

Global Business Voice: M&A Outlook II - The AGN Global Survey of M&A activity.



November 2021

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Business Alert: The AGN international barometer of M&A activity across the globe.

Introduction

This latest edition of the AGN global business voice survey follows M&A Outlook I ('The Calm Before The Storm') conducted early 2021 – which ostensibly gave us a snapshot of how AGN members' corporate finance activity had been impacted by the global pandemic. Volumes and values were down – but perhaps not as much as one might have expected, and it was clear that there was concern about future levels of distressed sales due to an anticipated downturn in economic fortunes.

Just over half a year later we now look again into this fascinating area and consider how M&A activity has fared. It would appear that many economies have bounced back with greater alacrity than might have at one point been expected. Regardless, some economies are now burdened with huge public debt and as pundits are pointing out, "someone will have to pay", and the question for us is how will that effect global M&A business?

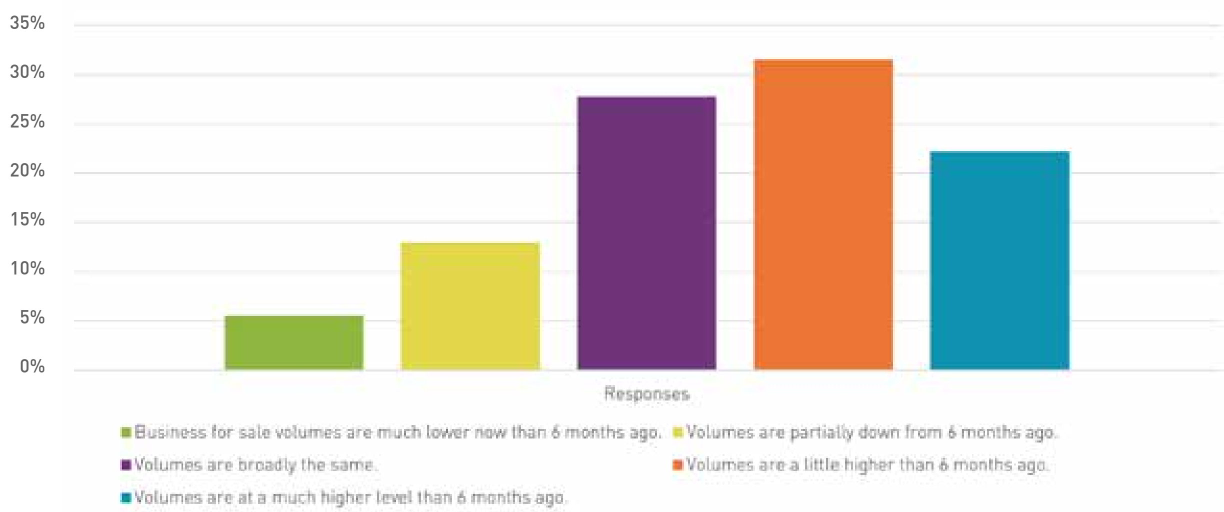
We have once again called upon our international panel of business advisory accountants spread around the world to give us a high-level opinion-based picture of what's happening in their region or country.

A DISTINCT TURNAROUND IN M&A VOLUMES

It's a broad-brush observation but our survey is telling us that a total of 81% of respondents reported that sales volumes were the 'same or increasing' – six months ago months this figure was only 14%! Clearly this suggests a distinct and sizeable improvement in M&A activity, which is further reinforced by the proportion agreeing that 'Volumes are much higher than 6 months ago' - at 22% this time compared to only 5% last time.

The proportion saying that volumes were 'down' or 'partially down' has fallen from 69% to only 19%. In summary it would appear that volumes have increased quite dramatically – a prediction made in M&A Outlook 1.

What has happened to business for sale volumes in your country in the last 6 months?



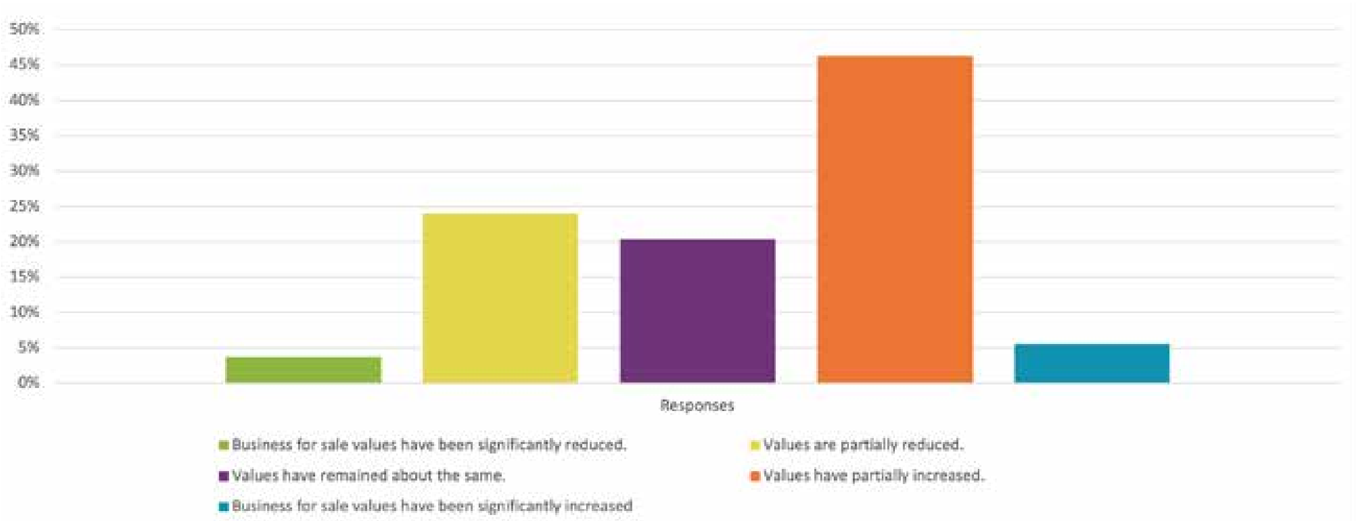
ANSWER CHOICES	RESPONSES
Business for sale volumes are much lower now than 6 months ago.	6%
Volumes are partially down from 6 months ago.	13%
Volumes are broadly the same.	28%
Volumes are a little higher than 6 months ago.	31%
Volumes are at a much higher level than 6 months ago.	22%

Looking more closely at some of the comments surrounding this question, we are right to highlight that our observations are 'broad brush'. Our respondents are keen to caveat their positive response with degrees of caution: "It all depends on the area of business", and beware of a built-in "Covid discount". However, in what emerges as a sort of sub plot in the research, some members were also suggesting their volumes could have been higher if it hadn't been for their own resource constraints!

VALUES ON THE WAY UP

Perhaps not surprisingly six months ago only 3% of respondents were able to report that values had partially increased, but today an enormous 46% are reporting that values have increased in the last six months. However, this result does come with a caution as values have only really increased in some very specific sectors (which we will come onto).

Over the last 6 months are local business valuations still being affected by the pandemic?



ANSWER CHOICES	RESPONSES
Business for sale values have been significantly reduced.	4%
Values are partially reduced.	24%
Values have remained about the same.	20%
Values have partially increased.	46%
Business for sale values have been significantly increased	6%

Our panel are keen to observe that 'value improvement' is "different from industry to industry" and that these increases in value "depend on the activity" and is "very industry specific".

This is a familiar story and last time when we looked at this question we were marvelling at how in some specific cases values were defying all the odds, bucking the trend, and flourishing in the face of massive falls in GDP and economic collapse. The economic 'bounce back' has been greater than was predicted but the story is similar – affecting more sectors at higher values, but again it's not across the board.

WINNERS & LOSERS

As mentioned above it's clear that while business values are on the way up for many, others are suffering quite deeply. In fact the gap between the winners and losers has probably deepened since we last reported on this.

WINNERS: Technology and communications | Building & Constructions | Business services and professions.

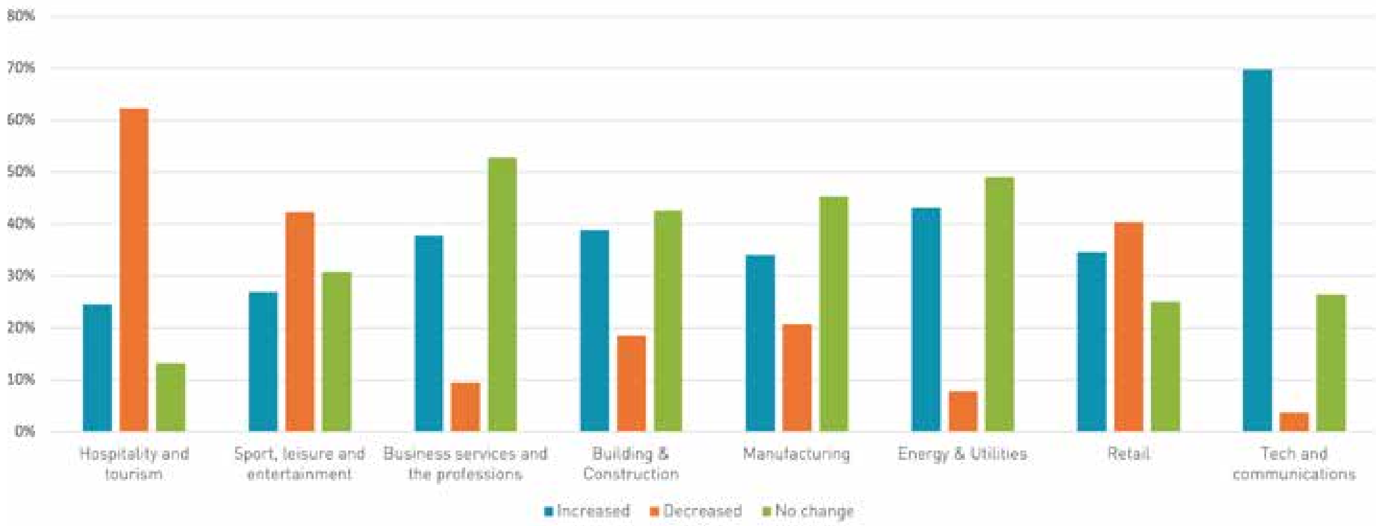
LOSERS: Hospitality & Tourism | Sport leisure & entertainment | Retail.

These results very much reflect the response we received six months ago, and we can see that the values in sport & leisure and hospitality & tourism have deepened still further. The good news for retail is that the decrease in values has slowed, but this most likely follows the increasing trend of retail to focus their attention to online environments and online shopping.

The overall increase in the values of technology (in particular) has swayed the result of this question – and it's the technology sector that is really the cause for the highly positive result to the previous question about values generally. Technology and communications businesses have benefited massively from the 'stay at home' diktat in many countries during the height of the pandemic, and tech-based business picked up the fall off in high street retail, whilst also benefitting from the switch to online entertainments. Add to this that tech and communications businesses tend to ignore geography and you can see why values have increased.

The global panel also noted the lively involvement of venture capital in deals that have been realised - perhaps an illustration of the volumes of capital that we know is present in the system at the moment.

Are there any sectors in particular where values have altered in the last 6 months?

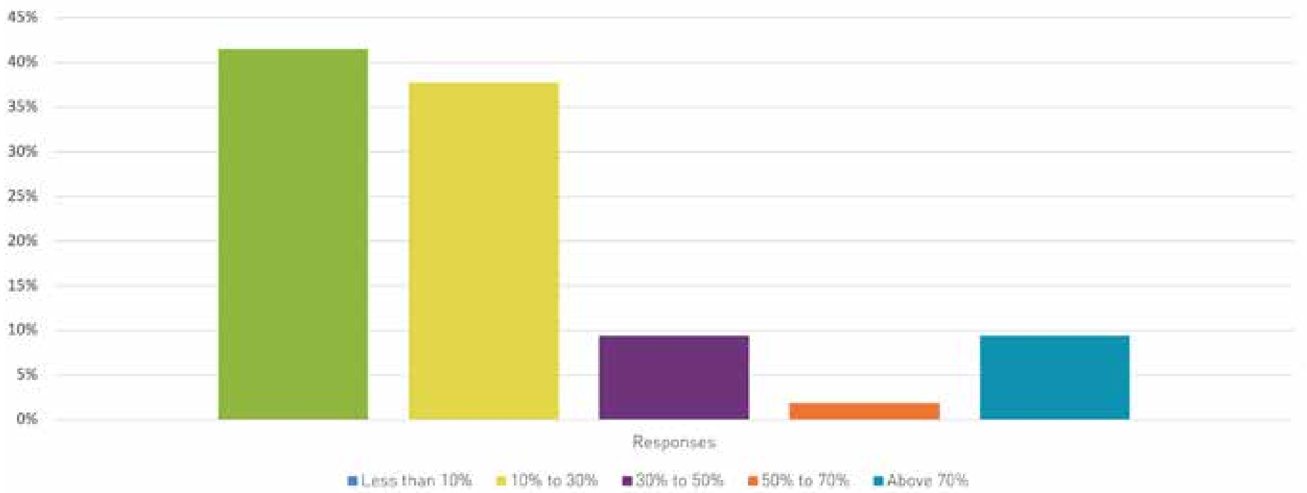


ANSWER CHOICES	INCREASED	DECREASED	NO CHANGE
Hospitality and tourism	25%	62%	13%
Sport, leisure and entertainment	27%	42%	31%
Business services and the professions	38%	9%	53%
Building & construction	39%	19%	43%
Manufacturing	34%	21%	45%
Energy & utilities	43%	8%	49%
Retail	35%	40%	25%
Tech and communications	70%	4%	26%

STORM HEADING OUR WAY?

Another 6 months on it's still not a picture of total collapse, although these results will vary from country to country and by sector. But over these 6 months those that reported distressed sales were running at above 70% has increased from only 2% to 12%, and the 70% that reported up to 30% was a distressed sale 6 months ago is now 80%. One might conclude we are beginning to see a change in the nature of this activity – the beginning perhaps of the 'storm', the foothills of significant future change as troubled businesses work their way through the system.

Over the last 6 months what proportion of business sales have been 'distressed', due to emergency restructuring (say) or to generate liquidity and cash?

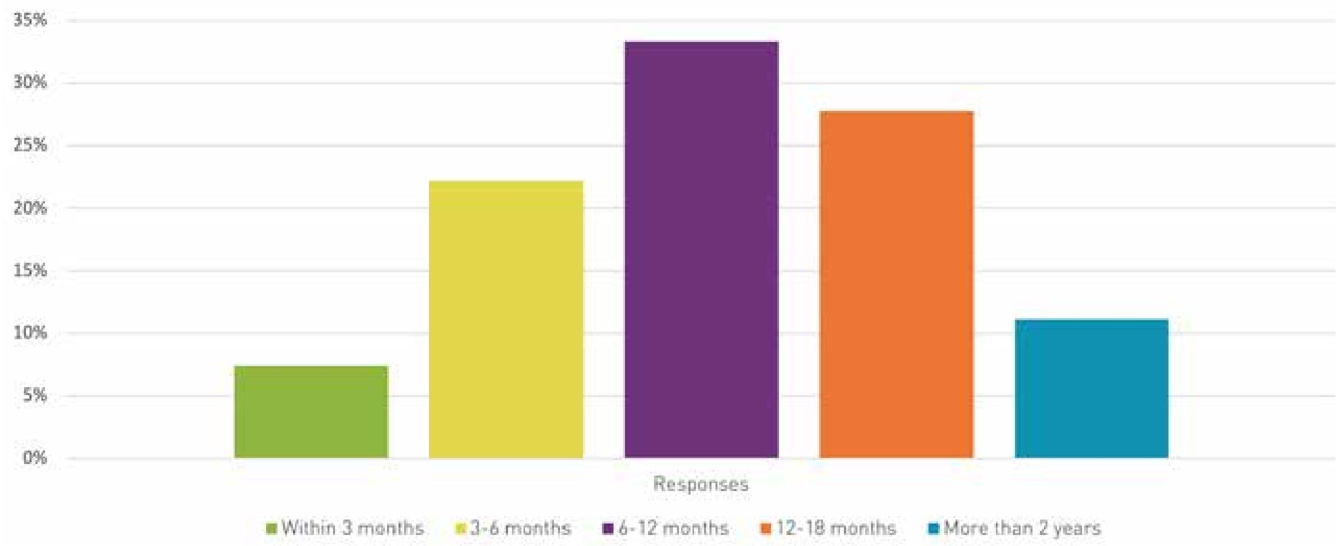


ANSWER CHOICES	RESPONSES
Less than 10%	42%
10% to 30%	38%
30% to 50%	9%
50% to 70%	2%
Above 70%	9%

ECONOMIC COLLAPSE NOT HERE...IS IT?

It would appear that the emergence of a wave of distressed fire sales due to the termination of government support schemes is getting closer but it's still not as iminent as predicted last time. This report is suggesting 60% will see this happening within 6 to 18 months whereas last time that number was 71%. It's fair to say that the majority are predicting these emergency sales to be within 3 to 18 months – so slightly closer than it was last time. In many territories the idea of economic recession due to Covid is receding and some are seeing a strong bounce back but, with the fear of damaging inflation on the horizon.

Many economies are beginning to emerge from the impact of the pandemic now, and conventionally, we see an increase in 'fire sales' and disposals as an economy comes out of recession - when do you think this will happen?



ANSWER CHOICES	RESPONSES
Within 3 months	7%
3-6 months	22%
6-12 months	33%
12-18 months	28%
More than 2 years	11%

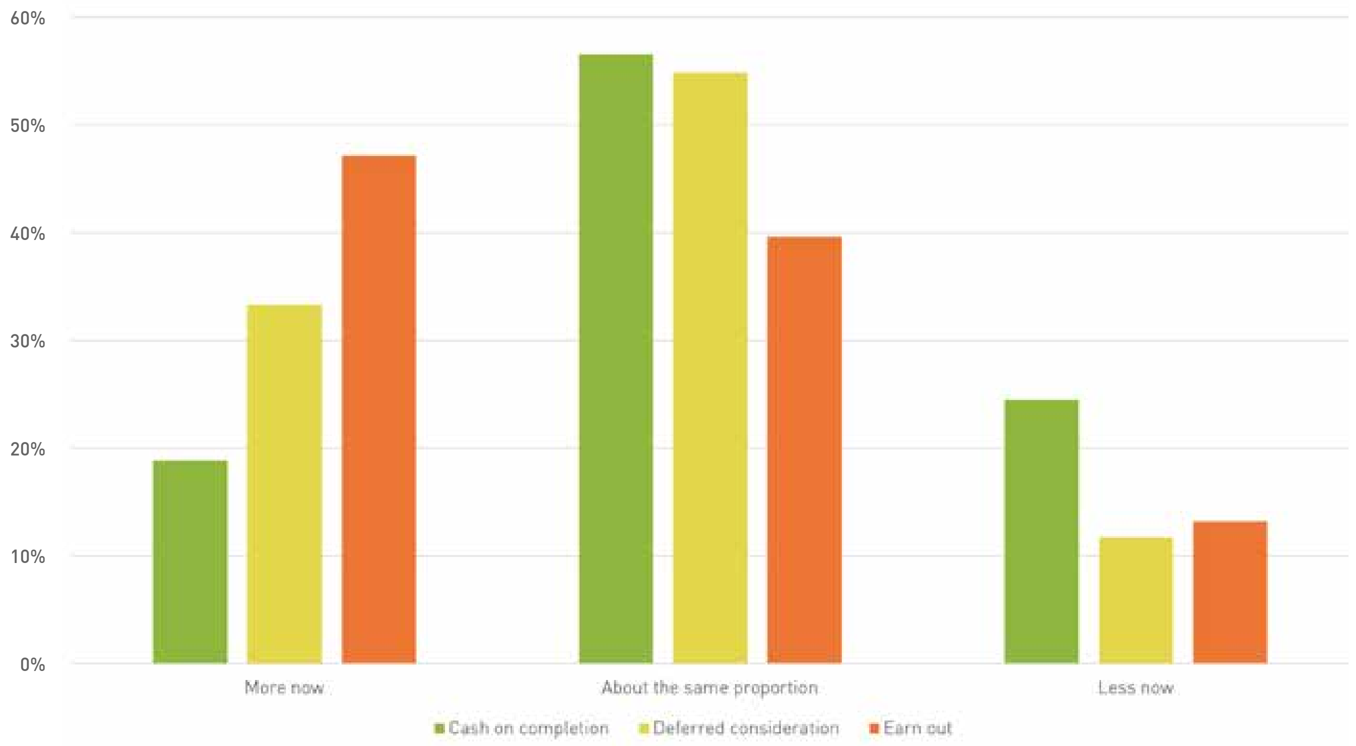
DEAL STRUCTURE CHANGING

A common problem encountered by all businesses and professionals as we journey through the pandemic is the undeniably high level of uncertainty that surrounds just about every aspect of business. We suspect that this is having an impact on how deals are being structured, and our panel tended to agree. There's been a notable move away from cash on completion to some form of deferred payment – and in particular a move to more 'earn-outs'.

There are some big advantages for a buyer in a deferred consideration or an 'earn-out'. It mitigates risk and it could even provide a funding mechanism for at least part of the deal. Because the buyer's risk is mitigated it can also mean that a buyer might consider a range of higher risk transactions that they otherwise wouldn't have considered.

For the seller the consequences could be profound. Those owners seeking to retire might need to bring forward their escape date and they may have to accept a degree of risk for business performance. There are likely to be considerable tax consequences that need to be accounted for.

Over the last 3 years do you think there has been a change in the structure of deals?



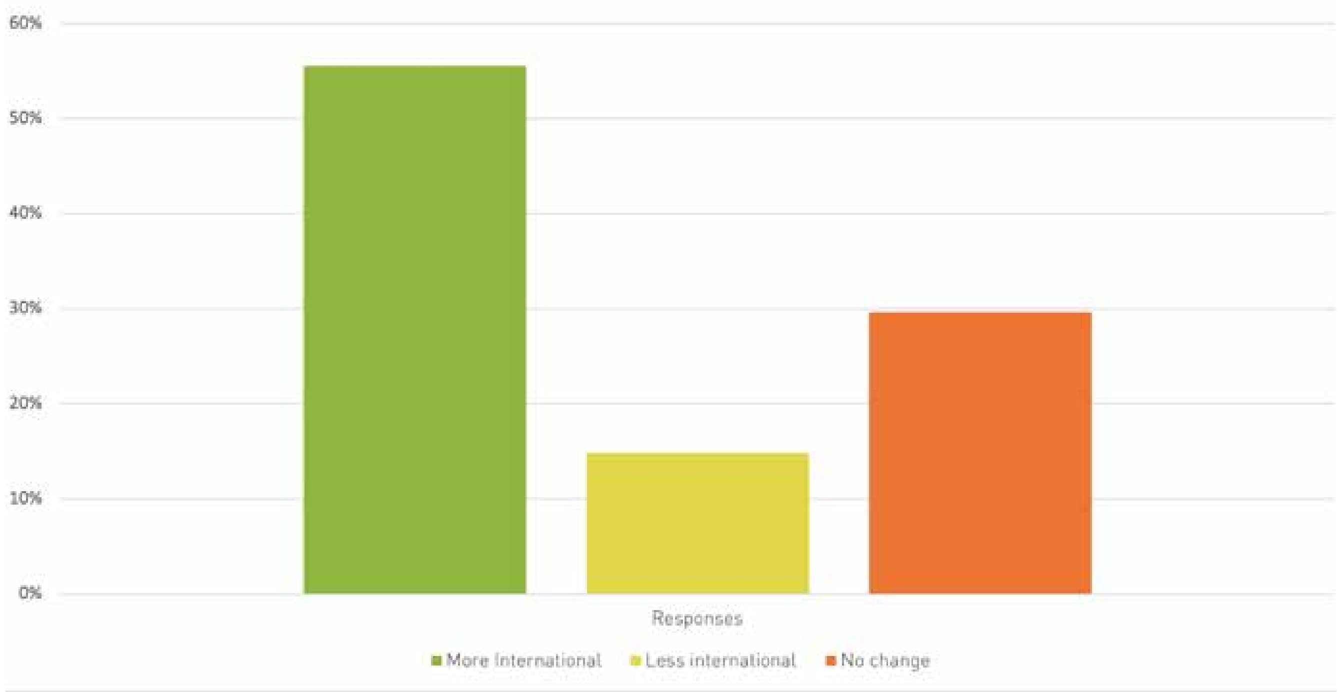
	MORE NOW	ABOUT THE SAME PROPORTION	LESS NOW
Cash on completion	19%	57%	25%
Deferred consideration	33%	55%	12%
Earn out	47%	40%	13%

CAPITAL KNOWS NO BORDERS

There are few metaphors as powerful for a globalised world as the idea of free-flowing capital exchanges across borders. The fact that many once prized national brands are in the hands of private individuals and companies from 'competitor nations' is seen as a price for equal access. Add to this the experience of the last 18 months, where regardless of travel restrictions, the world has seemingly got smaller through the use of video technology. Benign integrable systems and software, combined with a flourishing technology sector has seen an explosion in international deals.

It's unlikely that membership of an international association like AGN has ever been so useful at supporting either end of an international deal. An AGN member somewhere in the world might just have a client that could be the perfect match for a business being sold or on the acquisition trail.

Over the last 5 years do you think there has been a change in how 'international' deals have become?



ANSWER CHOICES	RESPONSES
More International	56%
Less international	15%
No change	30%

IN CONCLUSION

There has been a stark turnaround in volumes and values – but critically and mainly in key sectors such as tech and business services. The effect of the pandemic is waning. There has been a shift towards deferred risk mitigated deals of an international nature. The message is surely clear – if you have a fast-growing technology business in your stable of clients, it's worth getting clarity on their growth strategy and seeing how you might help them add capacity, revenue, new territories or new capability by matching them to similar clients of other AGN members.

As an organisation of corporate financiers and deal makers we need to continue to:

- **Keep an eye on clients in the troubled sectors - retail, hospitality, leisure and entertainment. Are they ripe for acquisition? Do they need financing? What can you do to support them?**

- **Which are your tech clients? Are they potentially acquisitive? Are they experiencing rapid growth? Or do they have a clear exit path?**

- **Do you have clients that have identified a retirement strategy? How might that be affected by the trend towards deferred considerations?**

- **And finally, are you properly leveraging the AGN M&A Sharegroup to identify international opportunities?**

The long-previewed shockwave of distressed sales still hasn't emerged but there are signs that it's getting closer. Is the marginal increase in 'fire sales' an indicator of much bigger changes to come?

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Note: This edition of the GBV is sponsored by the AGN Mergers & Acquisitions share-group - headed by Daniel Shear, the Corporate Finance Partner from our UK member BKL. Please get in touch with Daniel Daniel.Shear@bkl.co.uk if you would like to join this share-group.

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