In This Issue

Introduction: Subdued M&A Activity
U.S. Deal Value & Volume
EBITDA Multiples
EBITDA Multiples by Buyer Type
Debt Multiples
U.S. Deal Volume by Industry
Number of Deals by Buyer Type
**Subdued M&A Activity**

As profiled in the following pages and charts, U.S. M&A activity slowed sharply in the second quarter due to the economic shock resulting from the COVID-19 pandemic. Activity – especially involving lower-to-middle market businesses – is expected to remain muted for the duration of 2020 and throughout 2021 unless more effective therapeutics and/or vaccines are developed that facilitate a more bullish sentiment than currently prevails.

Although evidence is currently obscure, M&A markets appear to reflect wider bid-ask spreads among would-be sellers and buyers. Sellers are too fixated on what their business might have transacted for in 2019 while buyers expect to pay less as a result of declining performance and higher uncertainty regarding the magnitude and duration of the current economic malaise.

Numerous industries lack sufficiently motivated strategic buyers willing to overlook concerns for their existing businesses to say nothing of the integration of new business. On the other hand, certain financial buyers seem to have returned to the market looking to deploy capital at attractive valuations when and where acquisition financing is available at reasonable terms and pricing.

Would-be sellers face a dilemma: sell now for a seemingly compromised valuation; or wait for a recovery in market appetite that is not guaranteed to occur in the foreseeable future. Sellers are also faced with weighing the potential dilution of their future transaction proceeds if political regime/legislative change threatens the currently favorable tax environment. A modest consolation in the near-term for certain sellers may extend from the forgiveness of PPP loans under the CARES Act. As an aside from the current topical focus, sellers are advised to study the requirements and documentation for PPP forgiveness under change of control transaction events.

We believe that in the current environment, contingent payments (e.g., earnouts and/or clawbacks) and seller financing will be employed to a greater extent than in the past in order to bridge a widening bid-ask gap in deal value. Contingent deal consideration is typically structured such that a portion of transaction consideration is contingent upon the buyer’s achievement of specified post-transaction performance thresholds. The current environment requires careful seller scrutiny of such terms.

When reasonably structured and negotiated, contingent consideration results in a symmetrical risk for buyers and sellers. While the economics can vary, earnouts often provide an incremental tranche of deal value that reconciles to that debated 0.5x to perhaps 2.0x turn that comprises the typical bid-ask spread (usually EBITDA based). For the buyer, contingent consideration acts as an insurance policy to insulate against downside future performance. For the seller contingent consideration can deliver deal consideration over and above that at the closing table, thus facilitating upfront liquidity while allowing for potential upside versus a straight all-cash closing. Sellers are advised to be careful about their unwillingness to entertain contingent consideration in the current environment because doing so can be a signal to the buyer of the seller’s concerns about near-term performance (i.e., actions speak louder than words). As always, every transaction is unique, requiring careful assessment of contingent consideration for purposes of productive negotiation.

In theory, sellers may have to provide more financing in the post-COVID environment in order to achieve acceptable terms and pricing. We use the qualifier “in theory” because the high yield and leverage loan markets that are an important source of acquisition financing improved sharply as the third quarter progressed with more capital being raised at tighter spreads than the second quarter.
An additional concern that has slowed M&A activity is execution. Conducting due diligence during a pandemic is inherently difficult and fraught with its own complications. It is easy to imagine how due diligence would have ground to a complete halt in an era before electronic data rooms and Zoom Video meetings. Nonetheless, travel prohibitions and social distancing protocols have stymied due diligence as most buyers require site visits and face-to-face meetings in order to consummate a purchase agreement. However, issuing a non-binding LOI remains quite doable, and some buyers are eager to secure the optionally and potential exclusivity obtained by an LOI submission.

M&A in most industries is pro-cyclical. Challenges notwithstanding, M&A activity should gradually improve if the economy continues to do so and as buyers and sellers adjust expectations to the current environment and business earnings “normalize” in 2021 or 2022.

This resource center collects all our best thinking related to the impact of the COVID-19 pandemic. The content covers a broad range of topics and industries. As we publish new content, the list will be updated. See the list below for links to a few of the topics discussed in our resource center.

**Oil Frackers Are Breaking Records Again – In Bankruptcy Court**

Energy Valuation Insights Blog
September 1, 2020

**Planning for Post-Pandemic Life for Family Businesses**

Family Business Director Blog
August 24, 2020

**Estate Tax Planning May Be the Next Surprise for RIA Community**

RIA Valuation Insights Blog
August 10, 2020
Overall transaction value and volume in the middle market in the second quarter of 2020 fell dramatically from levels observed in 2018, 2019, and the first quarter of 2020. The precipitous drop in deal activity given the ongoing COVID-19 pandemic was to be expected, as federal, state, and local government “stay-at-home” and “shelter-in-place” mandates were in effect throughout the entirety of the quarter, severely hampering economic activity in the United States. These mandates were only beginning to permeate throughout the country during the first quarter and had only minimal effect on first quarter deal activity. From our anecdotal experience, many deals that would have otherwise announced or closed were forced to be put on hold due to executional and operational difficulties caused by the various shutdown orders. Additionally, most companies that might have been in the early phases of investigating a potential transaction likely put those plans on hold during the second quarter – especially in industries that have been directly negatively impacted by the pandemic and the economic shutdown.

**EBITDA Multiples**

Reported TEV/EBITDA multiples on private equity transactions across all tranches of enterprise value in the second quarter were virtually unchanged from the reported multiples in the first quarter. Volumes, as we noted earlier, were down, but the deals that did get done were at fairly consistent multiples. This follows our earlier point that any deals in industries most directly impacted by the pandemic likely did not happen. Additionally, many of these second quarter 2020 deals were likely well into negotiations (potentially even post letter of intent) when the pandemic first emerged in late February and early March. It will be interesting to watch whether valuation multiples can persist at these levels into the second half of 2020 on deals that are more likely to have been negotiated post-COVID.
EBITDA Multiples by Buyer Type

EBITDA multiples on all deals by financial (private equity) buyers remained fairly consistent through the first half of the year with levels seen in 2018 and 2019 at 7.4x. However, the premium paid by strategic buyers relative to financial buyers essentially disappeared in the second quarter, with multiples on strategic deals falling to around 7.2x. This fall was likely due to depressed asset pricing conditions across all financial markets during the second quarter.

Debt Multiples

Total debt multiples relative to EBITDA for financial buyers fell during the second quarter, reflecting both decreased transaction volume and a tighter credit environment as a result of the ongoing pandemic.
**U.S. Deal Volume by Industry**
Q1-2018 to Q2-2020

Source: Capital IQ

**Number of Deals by Buyer Type**
Q1-2018 to Q2-2020

Source: Capital IQ

**Bankruptcy and Restructuring Services**
Restructuring businesses need trustworthy independent financial advisors who can provide timely, relevant and useful advice on a range of strategic matters related to the bankruptcy and restructuring process. CLICK HERE to learn how Mercer Capital can help.

**Recent Solvency Opinions**

- National Mortgage Company
  Mercer Capital provided a solvency opinion in connection with a $150 million dividend paid to shareholders
  - September 2020

- Manufacturer of Specialty Building Materials
  Mercer Capital provided a solvency opinion in connection with a $43 million dividend paid to shareholders
  - September 2020
Transaction Advisory Services

In addition to our corporate valuation services, Mercer Capital provides investment banking and transaction advisory services to a broad range of public and private companies and financial institutions.

Mercer Capital has been successfully executing mergers & acquisitions for a broad spectrum of middle-market companies since the mid-1980s.

We specialize in providing merger & acquisition services to sellers or buyers of private businesses or public companies divesting divisions and subsidiaries. In addition, Mercer Capital assists clients in industry consolidations, roll-ups, and refinancings.

Mercer Capital leverages its historical valuation and investment banking experience to help clients navigate a critical transaction, providing timely, accurate and reliable results. We have significant experience advising boards of directors, management, trustees, and other fiduciaries of middle-market public and private companies in a wide range of industries. Our independent advice withstands scrutiny from shareholders, bondholders, the SEC, IRS, and other interested parties to a transaction, and we are well-versed in the new industry standards.

The professionals of Mercer Capital guide you through the uncharted waters of selling your business, acquiring another business or division, mergers, valuations, fairness opinions, and other transaction advisory needs. Rely on the experience, independence, and transaction know-how of Mercer Capital.

Transaction Advisory Services

- M&A Representation
- ESOP Installation, Termination, and Transactions
- Squeeze-Out Transactions
- Fairness and Solvency Opinions
- Minority Shareholder Stock Repurchases
- Corporate or Partnership Recapitalizations

Advantages We Offer

- Maximize Net Proceeds
- Negotiate the Best Possible Terms
- Speed Up the Deal Process
- Ensure Transaction Closure
- Help Ensure Confidentiality
- Minimize Burden on the Ownership

Nicholas J. Heinz, ASA
heinzn@mercercapital.com
901.685.2120

Timothy R. Lee, ASA
leet@mercercapital.com
901.322.9740

Jeff K. Davis, CFA
jeffdavis@mercercapital.com
615.345.0350

Matthew R. Crow, ASA, CFA
crowm@mercercapital.com
901.685.2120

John T. (Tripp) Crews, III
crewst@mercercapital.com
901.322.9735

Taryn E. Burgess, CFA, ABV
burgess@mercercapital.com
901.322.9757