2022 – The year of the transaction

M&A activity showed signs of increase in 2021, and 2022 promises to be the year of the transaction. The increase in M&A activity is a result of a number of factors and COVID-19 has been one of them.

The pandemic, a once in a hundred year event, placed businesses in an environment where management had no history, and no immediate playbook to guide them. Whilst virtually every country across the globe was impacted, the impact was not always at the same intensity or time. Business was disrupted, there were some winners and many, particularly smaller businesses, went through some tough trading periods.

Coming out of the pandemic or at least managing to work within the new normal environment, business owners and management took some time to reassess and prioritise what was needed for their business. For some it was the need for scale, the opportunity to perhaps buy market share at lower prices. For others it was a time to either sell up, or to change the ownership structure of the business. And for some in an ageing baby boomer generation it was time to bring forward that planned retirement.

All of this added impetus into a market where debt was relatively cheap, capital relatively easy to raise and where there were no shortage of business opportunities including cross border options.

Transactions come with risk and not all transactions are successful. Being transaction ready and being aware of some of the pitfalls, can significantly increase both the chances of success and the measure of success. This is true irrespective of whether you are a large or small business, and irrespective of whether you are on the buy side or the sell side of the transaction, the principles are the same.

Based on the transactions I have been involved with over 25 years, here are some of the key considerations.

Strategy – be clear on why you are doing what you are doing. Don't get caught up in market hype and the need for a 'me too' approach. Have a clear business strategy as your start point. Only proceed with transactions that are consistent with your overall strategy.

Price & value are not the same thing – it is essential to understand the value of any business you are buying or selling, however that is only the start point. In almost all markets price trades at a premium or discount to value. For businesses listed on a public stock exchange, price moves consistently based on market perception and the relativity between demand and supply of shares. For privately held businesses there is no open market and price is only determined at the time of a transaction. Good quality businesses in strong markets will almost invariably trade at a premium to value. Having a valuation on a business gives you a good base position. From there you need to decide on what premium or discount is achievable.

Being transaction ready – one common reason why transactions fall over is because one or both parties are not transaction ready. If you are the seller you should be prepared to complete a sale, have your financial data current, have an Information Memorandum on your business that provides a good business overview and showcases the strengths of the business, be ready for due diligence and know the price and terms you are looking to achieve. If you are the buyer you need to have your funding in place, know the price you are prepared to pay and the key terms that are essential to you in the transaction. Importantly both sides need to have people and time available to focus on getting the transaction completed.

Understand your counter-party – in over 50% of transactions the counter party is known. They may be a supplier, competitor, or someone in a complementary business channel. Take some time to understand them. Key things to understand include their capacity, motivation and people. Capacity is essential. You need to be reasonably certain that they are able to complete a transaction. Motivation is why do they want to do the transaction and how important is it to them. This goes to your bargaining position. It may be important to them to be able to complete the transaction quickly or to be able to announce it to the market. They may want to block one of their competitors who may also be interested in your business. Understanding the people you are dealing with is essential. We all have different personality types. Some work well with each other, some don't.

Be careful about synergy value – multiple studies show that buyers in most transactions over estimate the value of synergies. In any M&A transaction there may be synergies. These can be at either the expense line, where you believe there will be cost savings by combining the businesses or they may be at the revenue line where either new product or customer channels should be opened up as a result of the transaction. There is no question, synergies can turn a good transaction into a great transaction but be realistic with these. If you can only justify the transaction or the price you are going to pay through the synergy value, then the warning lights are flashing. Assess and quantify the synergies in the transaction but be conservative and realistic with them.

Use an experienced adviser – in most transactions you will want to use an adviser. An experienced adviser will pay for themselves many times over. They do this type of work all of the time and they can help you to avoid the pitfalls, negotiate around potential problems and identify better ways to structure and achieve an outcome. Importantly they should be dispassionate about the opportunity. It is likely that as a seller or buyer you will be emotionally invested in the transaction. This can lead to poor decision making. An experienced adviser will help you reduce this risk.

Be prepared to walk away from the deal – not every deal is a great deal and not every deal needs to be done. Sometimes the smartest move is to know when it is time to walk away. You should know in your own mind where your maximum price is if you are the buyer or the minimum price you will accept as a seller. You should also know the transaction terms which are essential to you and non negotiable.

It doesn't get better than the honeymoon – if the transaction is one where you will continue to work with the other party, it is essential that you have an effective working relationship and respect them. In the early stages of trying to get a deal across the line, everyone is on their best behaviour. If you are have difficulties or conflicts at the beginning it is only likely to get worse post the transaction.

The devil is in the detail – ensure that the sale and purchase agreement, shareholder agreements, employment agreements, put call options and any related agreements are fully documented and you have had good legal advice before you sign them. Generally, they are only important if something goes wrong, but if it does they will be essential to you.

Yes, 2022 is likely to be a busy year for transactions. At year end you want to be able to look back and be satisfied with what has happened. Following some simple steps will increase the likelihood of a successful transaction year.

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