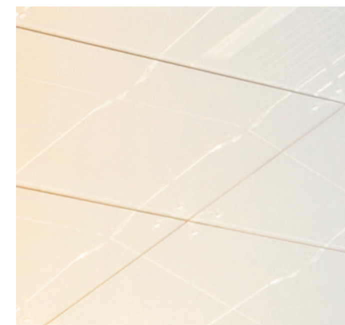
The Unpredictable Year: U.S. M&A Reflections and Projections

Contributor:
Rob Brown, Managing Director | CEO North America



To epidemiologists, a global pandemic was not a matter of "if," but "when." But to the rest of the world, the events of 2020 have been full of surprises. Today, much remains in flux: Americans brace for a second wave of the virus, Congress and the White House engage in a tug-of-war over potential stimulus, the stock market is a bit jittery and the presidential election continues to divide the country.

As we turn the corner into the final months of the year, we are taking account of this unpredictable year thus far—and outlining our projections of what may come to pass in the days ahead.

Top 3 Debunked Myths from 2020

When COVID-19 hit, the industry expected pervasive negative implications on deal-making and company health. These expectations, outlined and debunked below, turned out to be myths—not reality. In short: this year will close out far stronger than anticipated.

1 M&A Will Grind to a Halt

When we entered this period of economic uncertainty, the investment banking industry expected to see an increased demand for stressed or distressed activity and "healthy" or growth M&A to grind to a halt. We were wrong.

While M&A slowed industry-wide in the early months of the crisis, Lincoln has now seen material pickup. In fact, we have launched as many deals in the 3rd quarter this year amid a global pandemic as we did during a bull market last year. New business activity, a leading indicator for our business, is up 70% over the prior three months.

Looking back at the start of 2020, the private equity community's number one goal was to put more capital to work. With that in mind, PE firms have been hungry to invest in those businesses that have done well despite the hurdles during COVID-19—and now have compelling stories to tell about their performance during this period and/or outlook going forward. At the end of the day, the supply of capital available for new investments continues to greatly exceed the opportunities to invest in high quality companies.

2 The Stock Market Will Plummet

The stock market has held up better throughout COVID-19 than anyone anticipated.

At times, the stock market has seemed to be divorced from the events of the year. At others, the mercurial market has been easily swayed by news triggers. Stock market prices indicate that investors expect a strong recovery next year—perhaps investors anticipate approval of vaccine and therapeutic options and/or continued federal stimulus to sustain both businesses and consumer spending.

3 Distress Will be Ubiquitous

As in any down market, the industry expected many businesses to face challenges and require restructurings or distressed sales. Yet, the lenders to these businesses have been slow to force this activity despite increases in default rates. In addition, by propping up struggling businesses, in some cases federal stimulus may have masked the true economic damage that COVID-19 has caused.

What we know for sure is that both lender patience and government stimulus will not last forever. The day of reckoning for many companies in stressed and distressed sectors of the economy will come soon.

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Lincoln Perspective: Predictions for Q4 and Beyond

It is a hazardous game to place bets on what may happen in the remainder of this unpredictable year and beyond. But with the benefit of insight gained from the first half of the pandemic, we expect:

Owners Ready to Sell Pushing to Close Soon:
If both the White House and Congress turn blue on November 3rd, investors could see a material increase in capital gains tax rates. With this in mind, in the near term we expect business owners who were contemplating a sale to do everything within their power close a deal sooner rather later. While tax increases passed in Congress traditionally have taken affect in the following tax year, Congress has the right to make them retroactive to the beginning of the year.

A Good Year for M&A—And Restructuring:
Normally, a strong restructuring year is poor year for M&A and a strong M&A year is a poor year for restructuring. Yet, looking ahead, we expect both to do well. With capital to deploy, investors will continue to look for compelling businesses that have remained healthy during the pandemic or bounced back quickly with strong outlooks. At the same time, as economic stimulus dissipates and the fog clears, we'll also see that there is distress hiding in plain sight—revealing targets for opportunistic investors.

For M&A deals in 2021 we expect:

PPP Can Be a Dealbreaker:
Buyers have been clear that they are unwilling to take on risk associated with Paycheck Protection Plan (PPP) loans. Businesses with PPP loans may need to reduce their price, use an escrow agreement, or do an asset deal.

Lending Market Thawing Out:
With increased pricing and a tightening in capital availability, the lending market is not yet completely back to pre-pandemic levels. Yet, deals involving businesses with a strong COVID-19 growth story are precisely the transactions that lenders want to back. We are seeing aggressive levels of lending for these opportunities at pre-COVID-19 levels. For this reason, we expect that capital will remain available as buyers acquire attractive targets that have done well despite the pandemic.

M&A Matchmaking will Continue:
2020's M&A market has been marked by fewer broad processes and more bespoke matchmaking between buyers and sellers. We expect this trend to continue in the year ahead.

Virtual Deals Introduce Heightened Competition:
As we have seen this year, deals can get done 100% virtually. Generally, we expect strategics to be more likely to close entirely virtual deals than PE buyers. Among PE buyers, we are seeing a desire for people to meet in-person responsibly again, with PE chartering private planes to do their due diligence. With a scarcity of attractive acquisition targets, this dynamic invites a competitive spirit. Potential buyers want to know if others will be meeting face-to-face and do not want to find themselves at a disadvantage by missing out on an in-person meeting.