PREPPING FOR A DEAL

After a COVID lull, M&A activity burning into 2022

Normally with a lot of snowbirds vacationing in Florida after the holidays and into the early months of a new year, activity related to mergers and acquisitions doesn't start picking up in Minnesota for Lingate Financial until they return.

But already at the tail end of 2021 and trickling into 2022, the company has helped close on two sales, has another business that will be taken to market in late January or early February and another three internal transitions on which it is helping with valuation and deal structure.

"We're already seeing companies going to market that started the third and fourth quarter last year and are now executing," says Greg Loeschke, managing principal, adding that a lot of the companies that are starting to move have been held onto by owners who could have sold and retired or moved on several years ago but for various market reasons held onto ownership and have now survived and recovered through the COVID-19 pandemic. "We'll probably see a period here the next two or three years that will see companies going to market that took different timelines to get to the same point."

Pandemic, supply at play

The market is starting to feel a little like it did coming out of the recession in 2009 and 2010, he says. Just like now with COVID, some companies thrived during the recession and others took some time to recover before getting ready to move. So, given the time it takes to prepare to go to sale, observers say that indicates activity could be strong for the next couple years.

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by Andrew Tellijohn

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started the process in the third and fourth quarters of last year and now we're executing," he says. "And already we're getting initial inquiries, starting to have conversations with business owners that want some idea of value and what the market is like."

While the process, once started, typically takes six to nine months, Loeschke has been seeing some acceleration due to the pandemic and uncertainty around interest rate stability.

"Because of the number of companies that were negatively impacted by COVID, there's a lot fewer companies in the market," he says, adding that there are a lot of buyers of all types chasing the smaller count of available businesses. "I think there's some interest in buying groups where if they are interested in making an acquisition, to try and move as quickly as possible."

Readying your company

Loeschke says buyers will want several years of financial statements. He suggested getting them audited or, if not, at least prepared by an outside accounting firm. Businesses should also be keeping an eye on their cost of goods sold and administrative expenses and getting their record-keeping in order. And they'll need all their advisers assembled and on board ready to help.

"The best advice I can give … ahead of you starting the identification process as far as prospects, would be to make sure that they've got their team put together that is going to help them," Loeschke says.

Jon Schindel, a partner and attorney at SchindelSegal, says there is a lot of money from all sorts of different buyers out there waiting to be spent on acquisitions. He worked with an investment banker throughout 2021 who was looking to sell. Early conversations had a likely deal in the low-to-mid $30 million range, but when they finally closed with a different buyer in October, the price reached $38 million.

"Buyers are paying high from what I've seen," Schindel says. "There's lots of money out there in the [private equity] sector and not a lot of places to deploy it. Private equity firms looking to buy are having to overpay a little bit and they are doing so."

That mirrors what observers say the national market has looked like over the last year and change. To date, the market has acted favorably for sellers. Takeover targets in 2021 went for a median price of 16.2 times their earnings before interest, taxes, depreciation and amortization, according to Bloomberg Businessweek. That was in a market where U.S. companies were involved in $2.5 trillion worth of takeovers, well surpassing the previous record set in 2015 of $1.96 trillion. The total deal count was two-thirds higher than in that year and, according to the publication.

With that in mind, local observers say, a lot of companies that came through COVID in sufficiently good shape with owners who are considering their succession plans are starting to move quickly. So, how can you take advantage and maximize your sale price?

Schindel echoed Loeschke's plea for business owners to get and keep their financial statements in strong working order. Two more big steps sellers can take to improve their chances of a strong sale are signing big customers to long-term contracts to ensure they stay after a deal is completed and minimizing their own importance to the business by ensuring the company has a great management team in place. And that takes time.

"You're not going to hire a good management team overnight," Schindel says. "Your financials are not going to change overnight. … If you are an owner-operator, if you've got a good management team in place, values are higher because the buyer isn't beholden to the owner-operator. They're not relying on that. The more you can

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do to convince a buyer that the business isn't relying on one single person for its success, the better."

He also suggests owners be able to explain any blips on financial statements -- positive or negative -- associated with COVID. If revenue jumps, as they did for a dock manufacturer and installer he worked with that enjoyed a good 2020 when COVID drove families to the lake, the company must be able to explain why the increase is sustainable and not a blip.

"If you are a seller, I think you have to have a strategic plan to maintain, whether that's broadening services you offer or having a price increase," he says. "Show you have something in place, that it's not just luck."

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Explain interruptions, build talent around owner

Ben Hangge, a vice president and commercial banker with Highland Bank, is optimistic, though also a bit more cautious about the M&A market due to uncertainty around currently existing macroeconomic factors such as the omicron variant of the COVID-19 pandemic and ongoing supply chain interruptions. But he, too, thinks this should be a strong year for deals.

He works primarily with buyers and he reiterates the availability of capital.

"We certainly saw the purchase price multiples go up in 2021, which can be good or bad depending on what side of the transaction you are on," he says.

There had been the potential for buyers to get some deals on companies up for sale due at some level to financial statement disruptions, such as supply issues or labor shortages. Sell-side advisers have done a great job lately, he says, of explaining those situations, thus leading to fewer discounts.

He says buyers will see some opportunities to acquire businesses that were doing well where owners had minimized their involvement in daily activities until the pandemic made that more difficult. "It's made many sellers reprioritize and we have seen more businesses come on the market because of it," Hangge says.

There also will be opportunities for buyers to look for businesses where there is low-hanging fruit for improvement.

"Target businesses with clear areas for improvement, such as businesses with no marketing plan or no sales team or businesses that could benefit from [enterprise resource planning] implementation," he says.

For sellers looking to maximize the price of their sale, they can focus on reducing customer concentrations, en-

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sure that businesses can operate at full capacity without the seller and explain and document add backs or adjustments to EBITDA.

An EBITDA north of $3 million will get private equity firms interested in the business, Hangge adds, creating a larger pool of buyers.

"Typically the price gets bid up a bit through that process," he says. "I just hope there's not any negative macroeconomic event that happens. That's the only thing that could hold 2022 back."

Start early, plan what's next

Peggy DeMuse, a business broker with Sunbelt Business Advisors, says the M&A market was fired up even before COVID hit. While the pandemic will still create uncertainty, she says the youngest of the baby boomers are now reaching 65 and some of that uncertainty will likely start pushing more people toward being done with business ownership.

"I think there were definitely people that had been thinking 'You know what, it's been good, now it's probably time for me to go out and move along,'" she says. "Valuations are up. Buyer activity is up. Interest rates are down. Banks are lending. The SBA had some great programs in place last year to help buyers. So, it was just kind of a perfect storm."

Potential buyers, DeMuse says, should spend some time figuring out what type of business they might enjoy running. It's common to look at many before making a move.

They also should get financing in order. A typical loan with the U.S. Small Business Administration will require a 10 percent to 15 percent down payment. Arrange for a cushion so you've got money to operate the business, she adds.

"Every once in a while we get a call from someone who says they have $10,000," she says. "You just can't buy a business for $10,000."

On the sell-side, those with an inkling that their workdays may be coming to a close, she suggests getting started with planning early. Sit down with advisers who can help determine the company's value and talk about any changes that could be made to drive more.

"Often people are surprised," she says. "The better prepared you are by having some initial understanding of how a business like yours is valued is important. And if you are ready to go and understand the value and are happy with that, there is a whole process."

Finally, DeMuse adds, if you're going to sell your business take some time to figure out what the rest of your life looks like. Too many don't and it can make for a difficult transition.

"It's a very important part of the process," she says. "It's something sometimes people don't think about, and it is definitely something you should. Ideally, you have a plan in place. You've been working on this, you've been saving your entire life, you've been building your business all your life. What is your plan for when you don't want to work anymore? What is it you want to do? Having a plan in place is important."