An Update on the Merger and Acquisition Climate

By Lance R. Tullius

So many forces at play….what to make of current and future environment for M&A.

IT'S HARD TO KEEP UP WITH THE ONGOING changes in our world today. Fluidity is the one constant. If you unplugged for even a week, it's hard to say what you would miss. Since the start of 2018, we've had huge stock market fluctuations, began to see some of the early impact of tax reform, witnessed more domestic tragedies, viewed an Olympics that felt like a predecessor to a breaking point with North Korea (nobody knows if good or bad), come close to another government shutdown, and been presented with the first substantive feedback concerning the suspected interference of our election process by Russia.

The backdrop to all of this is a market and economy that have been bullish now for a long long time. For nearly 10 years, the prevailing direction has been due north. In March 2009, the Dow Jones was under 7,000. In 2018, it cleared 26,000, almost quadrupling its 10-year low. Think about that? The movement represents a 370-percent gain! For the most part, the rise has been steady, perhaps too steady. And, the rise has not been enjoyed by just the public markets either. Private companies have seen their valuations rise steadily during this period as well, providing business owners with an unprecedented window of opportunity by which to extract liquidity from their companies.

With all this said, there's nothing imminent to suggest (other than anecdotal logic.....i.e. what goes up must come down) that this run will come to an end anytime soon. But for those business owners trying to nail down the right time to sell their business, it may be helpful to consider what could derail this historic run.

The most important thing to understand is that the highs that we have and continue to see will eventually come down.

Many people accumulate wealth by acting opposite of the mainstream. In the midst of substantial stock market gains, they sell off some of their portfolio. Downturns? They buy. Similarly, in the private markets, as valuations rise, opportunistic business owners contemplate selling. In down markets, or when valuations are low, shrewd business owners actually double down on their business, invest in its growth, and prepare for the next good cycle. A driver to any market, good or bad, is supply and demand. In a market where valuations are high, characteristically you'll see more buyers than sellers, thus a "seller's market." Conversely, where there are more sellers than buyers, you have a "buyer's market" where valuations are lower. In either market, the scales can tilt rather quickly, thus moving the pendulum in the other side's favor. The scales can tilt for a number of reasons, but we'll focus on two that are particularly relevant to the current markets and center around psychology and demographics.

More private business owners are selling their businesses today, or view a sale as their imminent exit from their business, than ever before. This is not going to change. So naturally, the conscientious business owner is often pondering when they should sell. And, if not the most important factor in that decision, the value they can get for their business is almost always near the top of the list. When values climb to the extent they have recently and for the duration they have, a breaking point is eventually reached where more sellers come into play. The adage goes "everything is for sale for the right price." We are beginning to see this now. Many of the private transactions that are taking place now involve what I call opportunistic sellers versus committed sellers. Opportunistic sellers are those that did not plan to sell when they did but market conditions became such that they were drawn into considering and ultimately entering into a transaction. Committed sellers, on the other hand, are those that prepare in a more calculated fashion to actually market their business for a sale. Prices have reached a point, and held that point for long enough, that more business owners are taking advantage of what they view as a unique opportunity to sell their business for a premium. If this trend continues, the scales will surely tilt to a more buyer-friendly market.

The other factor that could substantially slow this market relates to population demographics. A very large percentage of our population falls into the baby boomer generation, a demographic that is entering their 70s. A large faction of this demographic are business owners, and for a host of reasons, many of these owners will sell their business to a third party in the very near future. We will likely see more transactions involving the sale of privately held businesses in the next 10 years than at any other similar time frame in history. But this spike will be initiated by business owners—the sellers—rather than buyers. This bodes well for buyers; not so much for sellers. How quickly this phenomenon really is felt remains to be seen. But it's almost a sure thing that it will and it's hard to imagine that it won't alter the merger and acquisition landscape.

The most important thing to understand is that the highs that we have and continue to see will eventually come down. It as close to inevitable as can be. Deciding when to sell your business is one of the most difficult decisions most business owners will ever make. So many different variables factor into the decision. And regardless of how attractive the current timing might be, it just may not be the right time for you to sell. That, of course, is each business owner's prerogative. But always try to be mindful of the conditions surrounding you, even though they're essentially beyond your control. Consult with your trusted advisors frequently to assess your own situation and how that may or may not line up with outside conditions. In that respect, whether you decide to make a move or not, you'll at least be empowered with information and knowledge.

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