

CROSBIE & COMPANY CANADIAN M&A SPECIAL REPORT – M&A OUTLOOK FOR 2021

A Reopening Market – Favorable to Sellers

When the pandemic hit in March 2020 a switch was flipped: we were hit with significant uncertainty and a range of practical issues that created strong headwinds for M&A. However, in recent months, we have learned to navigate some of these issues and the outlook for many businesses has begun to clarify. COVID has impacted businesses unevenly, with some driven to or over the brink while others demonstrated their resiliency or even thrived.

Now, with the positive vaccine developments and the expectation of widespread distribution in the first half of 2021, the headwinds should abate. More importantly, there is a growing confidence of improved business conditions with better visibility for the future. As this unfolds, for the reasons we will outline below, we think it is likely that M&A will rebound strongly and that conditions will be much more favorable for sellers than some might think.

Many business owners that were planning to begin a sale process in 2020 put their plans on hold when the pandemic hit. In 2021, we expect many of these business owners (particularly those with a supportive business case) to revisit their earlier thoughts of moving forward. There is also a meaningful demographic cohort of business owners that are likely to begin acting on their succession plans over the next few years, including some that are arguably overdue in doing so.

The strain of navigating through COVID over the past few months could well prove to be a catalyst for some business owners to pursue an exit earlier than they otherwise might have planned. In addition, there are a range of other situational factors that could act as drivers of M&A in the near term. For example, companies with balance sheet deficiencies resulting from COVID may use M&A as a solution to their problem. Accordingly, we have an expectation that many company owners will entertain M&A over the next several quarters for both COVID and non-COVID related reasons.

But with so much uncertainty in the broader economy, will 2021 actually be a good time to sell a business?

We think 2021 could potentially represent a better window for selling a business compared to waiting for two or three years. This line of thinking reflects a number of compelling fundamentals which could be very beneficial for sellers during 2021:

- *Valuations* – so far valuations have been very stable compared to pre-pandemic levels for many types of businesses. And in some sectors, valuations have even nudged higher. Today, for many businesses, valuation is not a reason to delay a process.
- *Government Stimulus* – the ongoing stimulus by many governments has helped support markets and restore confidence. However, stimulus cannot go on indefinitely. For now, it represents a tailwind for many businesses that will probably be missed once it is gone.

CROSBIE & COMPANY CANADIAN M&A SPECIAL REPORT – M&A OUTLOOK FOR 2021

- *Financing* – transaction financing conditions seem to be rebounding to pre-pandemic levels. Capital is plentiful, markets are liquid and the cost of money remains low. We are even seeing this in the private markets that are relevant to mid-market buyers where things slowed down materially for a period. In large part, this bounce reflects stimulative monetary policy and quantitative easing, not only in Canada but also in major markets globally. We definitely subscribe to a “lower for longer” view of rates but, as the pandemic has just taught us, there are no guarantees. For example, were we to have a “policy overshoot” causing central banks to adjust their stance, markets could react and become less supportive to M&A.
- *Buyers* – there is currently significant buyer appetite for M&A. This is a function of important fundamental drivers: huge amounts of private equity dry powder, growing activity among family offices and other types of non-institutional private capital, as well as renewed M&A interest among corporate buyers seeking to enhance their strategies, acquire growth and capture consolidation economics.

So, from where we stand, the fundamentals for the next few quarters seem solid. As well, pent-up demand throughout the economy as well as the psychology of a prospectively improving economy and business conditions are other big positives.

But a key question in our minds remains: how long will the window of opportunity made possible by these fundamentals remain open?

Today, the M&A market is probably constrained by the number of sellers and, moreover, by the number of quality sellers (i.e. those that can be positioned to demonstrate resiliency, sustainable competitive advantage, growth opportunities, etc.).

As time goes on, not only do we wonder about potential shifts to some of the above fundamentals but we also ponder whether the bloom could come off the proverbial rose as we move from the lens of a “prospective recovery/recovery in process” to a future lens where the new normal is better defined and understood. We also think there could be a change in buyer psychology and increased selectivity as more sellers enter the market as we move two and three years out.

What is the bottom line? There is a rational case for businesses with the right ingredients and story to entertain a sale process in 2021 so that they can take advantage of the good ingredients we see over the next few quarters. As they say, strike while the iron is hot.

On the other hand, once the initial exuberance wears off and more sellers enter the market, there will be the risk of the above fundamentals, market psychology and favorable supply/demand balance shifting – causing the M&A market to become less constructive to sellers.