What Will It Take For the Deal Market To Revive?

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The market for mergers and acquisitions is sheltering in place but may poke its head out as the country slowly emerges from lockdown.

In this time of economic disruption caused by the global health crisis, a perfect storm has hit the deal market. How long it lasts is anybody's guess, but for the moment most buyers and sellers are taking a pause while societies and economies sort through the current situation.

The deal market hates uncertainty, and the current market provides loads of it. To begin with, concerns over personal safety have created logistical roadblocks to closing deals. With non-essential travel curtailed, many sellers have tried to compensate with videoconference presentations and virtual facility tours. Those have proven to be a helpful but imperfect substitute for in person meetings and visits. Few buyers are willing to close on an acquisition based on a drone tour of a site.

Adding to the travel disruption is the impact of the restrictions on economic performance. Most companies who do not benefit directly from the health crisis have seen their financial performance decline. It has been very difficult to forecast revenue and profitability in this environment. While a seller of a business may have faith that their business will eventually return, potential buyers – who would not know the business as well as the owner/seller – are taking a more conservative view. Both sides recognize this gap in expectations. In response, both sides are putting things on pause until there is more clarity in the financial outlook of individual companies and the market as a whole.

Recessionary pressure on economic performance has reduced the amount of capital available for acquisitions. Many corporate buyers with strong balance sheets are conserving cash in order to ensure that they make it through the crisis. Banks and finance companies, who lend money to support acquisitions, are dealing with increased defaults and other issues in their existing loan portfolios. Their primary focus is working through those troubled loans. In most cases, any new lending has been put on hold, or if there is a willingness to make new loans, the bar has risen considerably.

Is the market completely shut down? Not entirely. Many deals are still pushing forward, usually at a slower pace. But activity is down. Based on our firm's own experience and a non-scientific poll of other dealmakers, we estimate that from late March through early May, about 80%-90% of deals went on hold or were otherwise disrupted. So far in May, we have not noticed a significant pickup in activity.

There are three key factors that will help the deal market return. One is an easing of travel restrictions, which has already begun. The second is greater clarity on the financial and economic outlook. We are seeing anecdotal evidence from some of our clients who have experienced an uptick in sales activity in the first half of May. We will want to see that continue and expand more broadly across the market. The third factor is a return of the debt markets. That is more likely to follow a return of financial stability.

We remain optimistic that activity will begin to return this summer unless the health restrictions tighten again. Until then, buyers and sellers will need to be patient.

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