CRAIN'S DETROIT BUSINESS

You may not reproduce, display on a website, distribute, sell or republish this article or data, or the information contained therein, without prior written consent. This printout and/or PDF is for personal usage only and not for any promotional usage. © Crain Communications Inc.

November 29, 2021 11:18 AM | UPDATED 45 MINUTES AGO

'Robust' M&A poised to carry into next year, and rising distress could produce more

NICK MANES

Getty Images/iStockphoto

"Red hot." "Turbo-charged."

Those are just some of the adjectives that professionals in the mergers and acquisitions space are using to describe the current market.

That can be great news for those looking to sell businesses, as valuations for companies remain high, which is usually based on a calculation derived by multiplying a company's revenue or earnings.

Data also suggests that the conditions could carry well into next year, and many M&A practitioners say their pipeline for work remains strong.

But also on the horizon is the likelihood that some element of distressed M&A — acquiring troubled companies — that is also likely to return in the coming months, after a years-long absence, given the drying up of federal stimulus funds.

"We're in one of the hottest M&A markets of my career," said Tom Vaughn, a corporate finance and M&A attorney in the Detroit office of the Dykema law firm.

Indeed, the Detroit-based firm just released its 17th annual M&A outlook survey and 75 percent of respondents said they expect the M&A market to "strengthen" over the next 12 months. Ninety percent said they expect an increase in the amount private M&A over the next 12 months.

"In the year to come, it looks like nothing — not the latest surge in COVID-19 cases, the Biden administration's legislative agenda or economic uncertainties — will be able to break

the stride of M&A dealmakers," reads the Dykema M&A report.

Millions and billions of reasons to sell

For examples of the red-hot market, one need look no further than recent headlines.

Legendary Michigan brewery Bell's Brewery Inc. in Kalamazoo County earlier this month became the latest craft brewery to cash in, with founder Larry Bell selling the company for an undisclosed price to Lion Little World Beverages, an Australian brewing conglomerate which also owns Fort Collins, Colo.-based New Belgium Brewing Co.

In early November, Farmington Hills-based Level One Bancorp. Inc. joined the ongoing trend of banking consolidation, as it announced a plan to sell to an Indiana bank, First Merchants Corp., in a deal valued at over $323 million.

Dealmaking has also been plentiful among companies with far less name recognition.

All told, M&A activity hit a global record in the third quarter of this year with total deal value of $1.52 trillion, according to a late-September Reuters report, which cited data from Refintiv. The total deal value was a 38 percent boost over the same quarter in 2020.

M&A executives are quick to note that each deal is different but also point out that there are a handful of common threads.

"It's a very rich and robust market," said Rajesh Kothari, managing director at Southfield-based investment banking firm Cascade Partners LLC. "There's a lot of capital, interest rates are down. You had a little bit of pent-up demand to start the year. And then you throw on top of it a potential tax hike, and it's a bonanza."

Rajesh Kothari

The Dykema report shows that roughly a quarter of respondents cited one of three major drivers for the wave of M&A activity: general U.S. economic conditions, availability of capital or financial markets.

Just 7 percent cited potential changes to U.S. tax law.

For many veteran business owners who went through the tumult following the 9/11 terrorist attacks in the early 2000s, and then slogged through the Great Recession, the COVID-19 pandemic was simply a final straw.

"I'm done," has been a familiar refrain from sellers, according to Heather Madland, a partner heading up business development at Detroit private equity firm Huron Capital.

The good news for such owners is that buyers are out there, particularly in the PE sector.

And they have money to spend. A lot of it.

Globally, an S&P Global Market Intelligence report from August showed that private equity funds hold nearly $2.3 trillion in capital committed by investors but not yet spent, commonly called "dry powder," and funds are obligated to put that money to work for their investors.

More than $500 billion of that is held by just 25 private investment firms.

Given the large amount of private money chasing deals — along with the duty of PE funds to put investor dollars to work — Vaughn with the Dykema law firm said he could see a scenario in which the U.S. economy enters a recession, but the M&A market remains strong due to the sheer amount of private equity capital that must be deployed for transactions.

Some M&A experts aren't sure that's a good thing.

"There's too much capital out there," said Alex Calderone, president of Calderone Advisory Group LLC, a Birmingham-based restructuring firm for distressed companies.

"If you look at what happens when there's too much capital, one of the consequences is inflation," said Calderone. "And we're seeing the price of gas go up, we're seeing food inflation. So it shouldn't come as a surprise to anyone that we're seeing inflation in the context of … the purchase prices of businesses. There's simply too much capital out there chasing yield."

Heather Madland

Madland with the Huron Capital PE firm, however, largely dismissed the notion that there's a direct connection between the consumer inflation that's ongoing and increased prices being paid for business acquisitions.

The drivers for inflation in the broader economy are different than what's driving rising multiples that financial buyers like Huron Capital are paying for companies, she argued.

"The math is still working for valuations where they are," said Madland. "Are there certain sectors that I think are overvalued? Yes. But those are for fundamentally different reasons than the whole market being overvalued."

Distress ahead?

Perhaps one bright spot of the COVID-19 pandemic has been the trillions in government spending used to support the U.S. economy and businesses as the virus has continued

raging, presenting further uncertain conditions.

With scant evidence that the federal government plans to pass any further virus-related stimulus, M&A executives working in the restructuring and distressed side of the business expect their workloads to pick up in the new year.

"Distressed M&A has basically been non-existent (for years) and is actually starting to pick up a little bit," said Steven Wybo, a senior managing director in the Birmingham office of restructuring firm Riveron Consulting LLC, previously known as Conway MacKenzie.

The "massive volatility" that's impacting automotive suppliers specifically, as well as other companies — from a lack of semiconductors to rising wages and materials costs — coupled with the drying up of government stimulus, is all but assured to lead to companies with troubled balance sheets being forced to sell, he said.

"I think this margin compression and this inflation, much of which is probably permanent for awhile, is causing more distress than we saw during COVID, and certainly before COVID when the economy was doing great," said Wybo. "So you're going to see a lot more, in my opinion, distressed M&A into 2022 in the middle market."

Calderone, also on the restructuring side of M&A, said he's also expecting a significant uptick in business in the coming months, for many of the same reasons mentioned by Wybo.

"My livelihood, to some degree, is dependent on some amount of distress in the markets," he said. "We're coming off of 18 months of just fiction. I'll use the analogy akin to a child riding a bike: the training wheels are going to come off."

Inline Play

Source URL: *https://www.crainsdetroit.com/finance/robust-ma-poised-carry-next-year-and-rising-distress-could-produce-more*