M&A

TO DEAL OR NOT TO DEAL

In a capital constrained environment, some might argue that now is not the time for businesses to be pursuing growth via M&A. Others might posit that the best deals are struck at weak points in the economic cycle. Senior Editor **Jacob Ambrose Willson** asks Criticaleye Members for their views on executing M&A in 2023 and beyond

In the first quarter of 2023, the total value of global mergers and acquisitions (M&A) was $413 billion. This represents a sharp decline of 44 percent when compared to the same period in 2022, according to recent research by GlobalData.

This significant drop in dealmaking will come as no surprise to business analysts the world over, given the macroeconomic forces that continue to place a strain on the finances of companies, large and small alike.

The two-headed beast of sticky inflation and rising interest rates in the opening months of the year have reduced cash reserves in even the most well-run businesses and increased the cost of debt, which has effectively shrunk the arena in which M&A deals remain palatable.

However, there clearly remains a market for dealmaking even in the depths of the current economic cycle. Criticaleye's recent Growth Company Retreat Research revealed that 31 percent of attendees 'will definitely' conduct M&A over the next 12 months. A further 24 percent confirmed they are 'considering targets'.

Michel Driessen, Senior Partner, Strategy and Transactions at EY UKI, believes a 'buyers' market has emerged and is changing the dynamics in the world of M&A. "If you're a contrarian, you invest when times are tough and you cut costs when times are good.

"I also think the UK market is attractive at the moment. There are great companies with good management but market capitalisations are below peers and especially below the US, which makes them very attractive from a price-to-value perspective."

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>
> Alastair Mills

Alastair Mills, Managing Director & Head of European Business Services at H.I.G. Capital, believes that there are less opportunities coming to market at present, due to an increased sell-side focus on the quality of assets potentially up for divestment. "Sellers will be cognisant of the fact that if they launch something now, they probably need to have a better story than perhaps 12-18 months ago. Buyers will look for more reasons to decline, to include a deferred / contingent component or opt to pay less.

"If it's a private equity transaction, the cost of debt associated with any deal has increased dramatically. So, to generate the same returns - almost by definition - you have to pay less, as the operating business case - in most instances - has not improved."

In recent years, PE houses have become increasingly used to relying upon debt funds to underwrite M&A transactions at high valuations, according to **Alastair**, so the current situation in the debt market is having a profound impact on dealmaking. "Just finding liquidity for anything but the best [credit] opportunities is quite difficult at the moment," he explains.

This prospect of achieving attractive returns on sensible investments made at the bottom of the cycle seems to be driving some of the sentiment towards M&A in 2023, with a particular weighting towards the second half of the year, when more debt likely becomes available to grease the wheels of private equity.

"A significant number of advisors are still actively pitching for sell-side opportunities and many have a reasonable number of mandates pencilled in for a post-summer launch, market conditions permitting," says **Alastair**. "Everyone recognises that there's still a lot of capital that needs to be deployed and over time, that results in a re-appraisement of buyer risk. If that is combined with an adjustment in seller expectations, it should trigger a material increase in completed transactions.

"We will also have another six months or so of data showing how specific businesses have performed in the current environment and, as we move later into the year, we'll begin to have insights into the impact of a full year of higher interest rates, which will help thoughts on structuring for the next deal and the diligence process." >

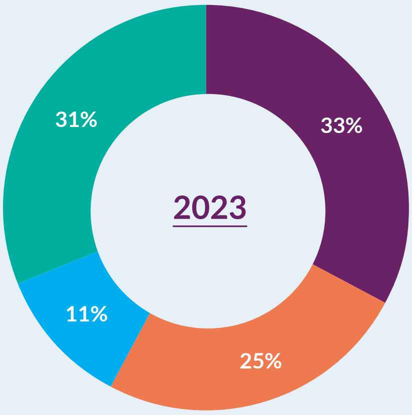
Growth Mindset

While the prospect of securing a cut-price acquisition may seem tempting to many executives of high growth companies, it's imperative to recognise that any potential M&A deal must deliver clear strategic benefits to the acquirer.

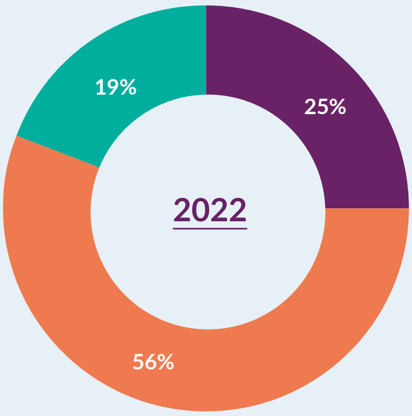
Smart customer generation platform MVF is one example of a high growth organisation that has combined rapid organic growth with a series of M&A transactions over the last five or six years. MVF CEO **Michael Teixeira** comments: "What we've strategically focused on with all of our acquisitions is revenue synergies. They're always about buying audiences, websites or client bases that we can integrate into our business and accelerate our own growth. That's been the common theme through all of those acquisitions.

"That strategic case is really fundamental and it's always got to be the first thing that you think of when buying assets. We've made sure to have a very clear strategic view, in all cases, to understand what the longer-term revenue synergies are, and the near-term revenue synergies which can de-risk the deal. The result is that all of those deals have been accretive for us."

Do you expect to conduct M&A over the next 12 months?



- We definitely will 33%
- We're considering targets 25%
- Unlikely as pricing remains too high 11%
- No, we will not be undertaking acquisitions 31%



- We definitely will 25%
- We're considering targets 56%
- Unlikely as pricing remains too high 0%
- No, we will not be undertaking acquisitions 19%

Source: Criticaleye Growth Company Retreat Research 2023

Finding the right balance between exciting upsides and credible downsides is always a difficult path to tread, according to **Michael**. "We have a good track record of success in M&A, but with each transaction you want the next one to be bigger and you want to take more of a risk.

"It's really important to go into those opportunities with open eyes and take your Board and other stakeholders with you on that journey, where you're being very clear eyed about what every acquisition looks like."

Michael also refers to bi-weekly meetings between the leadership team and the Board M&A sub-committee, which includes one of MVF's PE directors and one of MVF's Founders. "That's a helpful way to ensure we're staying in line with the Board as things progress, but also tapping into Bridgepoint's expertise in this area and the Founder experience too. They've been really wise contributors to that process and supported us in our ambitions."

Helen Wiseman, Chair of the ASX-listed Elixinol Wellness, comments that now could be an excellent time to conduct M&A, but it's always worthwhile not to underestimate the risks involved. "The acquisition process itself can take months longer than you expect," she says. "There are so many external variables that all need to come together on a timely basis to make the acquisition effective. You need sufficient capital to be able to fund that period, and particularly fund the legal and due diligence costs that go with it.

"You also then need the capital to make sure that you do the implementation properly because, as is well known, >

a significant proportion of M&A deals never realise the true benefit of the synergies. For capital constrained companies, that's a real watch point."

Helen emphasizes the importance of the Chair and non-executive directors when a deal is on the table: "As Board members our role is to challenge – if not temper – optimism. The role of the Board is to see the opportunity that's been presented – and not be blinkered by it – but also to challenge the risk side of it."

Having a highly proficient Board that can analyse potential transactions through the lens of several careers worth of experience can be a necessary counterbalance – for example – to the exuberance of a new CEO looking to make a splash with an attractive-looking acquisition, she adds.

Transformation

Another significant factor pushing executives towards the M&A door in the current environment is the sheer scale of transformation taking place along technological, social and economic lines. These era-defining shifts are already impacting business models and decision-making at the top level, but it can be difficult for legacy businesses to keep up with the current pace of change.

Helen explains: "Maybe in the acquisition, you're not just looking at the earnings accretion potential, but for certain skill-sets or market positioning that's far more attuned to those areas where your business models are being challenged. It comes to that diversification opportunity and when you can't transform your business fast enough."

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>
> Helen Wiseman

For **Michel**, businesses must be able to adapt to the multiple sources of disruption they're facing. "Be bold," he states. "The environment is changing very quickly, fundamentals are now different and mechanics are not as clear cut as they used to be. We're currently seeing a convergence of market sectors. For example, is Amazon the largest retailer in the world or a technology company? So, for other companies, it's about thinking where you want to be. Do you stay small and become a niche player, or look to do something different?"

Diversification has been the hallmark of MVF's success, by **Michael's** own admission. The company's ability to expand into new regions, channels and sectors has been achieved via the M&A deals struck during a hugely volatile period. "As a business with a focus on growth, we expect volatility. I think growth is never a straight line, it's always a bit spiky. Accepting this and growing in response to that volatility is what's really important. It's keeping your eye on the prize, knowing what your growth drivers are and working on them relentlessly, and being confident that good news will offset bad news if you work on the right things."

The risks inherent in the current dealmaking environment are numerous and have the potential to be fatal should a process fail. However, those businesses that approach M&A with a clear strategy, a beefed-up due diligence register and the fortune of a strong cash position or equity backing put themselves in an optimal position to capitalise on the weak point in the economic cycle. ■

GROWTH COMPANY FORUM 2023

Criticaleye is hosting its annual Growth Company Forum on 28 September.

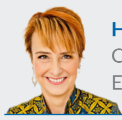
Please click here for more information or to register to attend this virtual event.

Featuring Commentary From:

Michel Driessen
Senior Partner
Strategy and Transactions, EY

Alastair Mills
Managing Director & Head of European Business Services, H.I.G. Capital

Michael Teixeira
CEO
MVF



Helen Wiseman
Chair
Elixinol Wellness

Contact the contributors through: www.criticaleye.com