MarketWatch

Opinion: The M&A market is grim — why that may be great news for some companies

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Both sides — buyer and seller — are in the same boat, providing additional motivation to get deals done

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Entering 2020, it seemed that merger-and-acquisition activity was on course for a steady, if unspectacular, year that could only be derailed by some kind of unthinkable "black swan" event.

Then came the COVID-19 crisis.

It's no exaggeration to say that the coronavirus pandemic and subsequent economic shutdown have pushed the M&A world into uncharted waters. Not only is the economic paralysis worse than that which followed the 2008 financial crisis, but also there's no clear end in sight.

Meanwhile, social distancing is going to demand a whole new way of getting deals done without the handshakes and physical meetings that have traditionally been vital to building confidence on both sides.

U.S. deal volumes plunged by half to $252 billion in the first quarter from a year earlier, with the vast majority of the fall accounted for by March when the pandemic began to hit hard. Global M&A dropped 28% in the same period.

Poor M&A market

The picture is likely to be worse in the second quarter, with many M&A deals grinding to a halt. More deals are falling apart or in limbo than are being completed, highlighted at the top end by Xerox's XRX, -3.15% decision to abandon its $35 billion hostile bid for HP HPQ, -0.57%.

The problem isn't a lack of cash or appetite for deals by private equity players. On the contrary, my phone has been ringing off the hook with requests from PE firms for good deals, stressing their willingness to be creative and pledging they won't seek to take advantage of the crisis with predatory behavior.

The $1 trillion or so in committed capital with PE and venture capital firms, or “dry powder,” is still out there; it just has fewer opportunities to be deployed because companies that were considering deals have withdrawn into their shells in reaction to the crisis.

Less-crowded arena

It may seem counter-intuitive, but this could be an excellent time for some companies to move forward with deals, particularly if COVID has been neutral to positive. Whereas in normal times they might be just one in a crowded field of contenders for PE money, they’ll now be in a position to get attention from a group of eager suitors, perhaps at higher than recent historical values.

PE general partners are under heavy pressure to find good deals because the clock is running down on capital commitments from their limited partners. When those commitments expire, it has a cascading negative effect on GPs’ income from fees and profits, and on their ability to raise funds in the future.

For certain, some deals will go ahead during this period. The pandemic has served as a jolting reminder to some business owners of their vulnerability to external events.

For business owners negatively impacted by COVID, they may be inclined to accept transactions that meet their personal goals, even if the value is 20% to 30% lower than it would have been just a few months ago. Other companies will welcome the chance to offload some of their non-core operations so they can focus fully on protecting their core business during the crisis.

Still, the deal flow is only going to come back in force when the current disconnect in value perception between buyers and sellers starts to narrow. That gap always exists, but is small enough in normal times for transactions to go ahead. In volatile periods, the gap is often too big.

New reality

For the gap to narrow, mindsets will need to change on both sides. A lot of business owners are still in the initial phases of shock or denial and have yet to accept the new reality. Inevitably, many businesses will need injections of capital to survive the coming recession, even if they’re valued significantly lower than they would have been in January.

For their part, investors need to be open to creative solutions and shouldn’t lose sight of a business’s long-term prospects even if it’s going through hell at the moment.

It seems clear, for example, that the trend toward value-priced e-commerce is going to be strengthened long term as we emerge from the immediate health and economic crisis. In the short term, though, many of those players are being pummeled by the freeze in consumer spending.

This bunker mentality should ease in the coming months as both buyers and sellers turn their attention from fighting fires to long-term prospects. In the end, though, the best hope for a relatively quick recovery in deal flow is if the coronavirus crisis itself turns out to be temporary, enabling us to replace the current ambiguity with more clarity.

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