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Mergers and Acquisitions Predictions for Remainder of 2020

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The COVID-19 pandemic has had an unprecedented impact on the New Zealand M&A scene already—affecting, in particular, New Zealand's export, tourism, hospitality and education sectors.

We have seen both transactions in the works and well-advanced transactions get renegotiated, postponed or terminated in the last couple of weeks, as clients get to grips with the brave new world we are facing and attempt to navigate around the uncertainty.

Many advisory firms had cautiously painted a reasonably positive outlook for deal activity in 2020, but that prediction will be tested hard. Credit is likely to become tighter, although those with easy access to cash remain well-positioned to capitalise on the opportunities that are likely to surface in the coming weeks. Businesses with robust systems, processes, strong balance sheets and cash flows will ride out the pandemic in a better shape than others. However, those that are less equipped to respond to our present challenges will struggle and may even collapse.

Although we are reluctant to predict too much doom and gloom for the remainder of 2020, we do expect a significant slowdown in local deal flow as we head into the winter months, with buyers and sellers taking a 'wait and see' approach for a period. We expect this particularly in the mid-market and above (\$50 million valuation and above), as owners of solid businesses decide to hold onto their assets until an end comes within sight for COVID-19-related issues. Even as

the outlook improves towards the beginning of Q4, depending on the number and scale of distressed asset transactions during Q2 and Q3, prices are likely to be at lower multiples than what we have seen in 2018/2019, with greater focus being placed on sustainability of earnings. These timing predictions could, of course, be heavily influenced by how quickly we can move out of (and remain out of) the current COVID-19 Alert Level 4 environment. Hand-in-hand with lower transaction prices, we expect payment mechanisms such as earnouts and deferred consideration to become increasingly popular, as greater focus is placed on verifying the value of acquisitions over time.

We have a more positive outlook for the lower end of the price spectrum. Smaller deals (\$15 million and below) involving good assets will continue to be attractive targets for cashed-up buyers, including private equity and venture capital funds, who are always on the lookout for opportunities. Also, regardless of their size, businesses that have found themselves operating in one of the "essential services" sectors in the current environment are likely to command greater buy-side demand and higher valuation than they did previously.

In the public markets, we do not expect the current flow of takeover activity to cease, as share prices take a severe hit from their all-time highs and investors lose patience with market volatility. Execution of take-private transactions announced prior to the COVID-19 pandemic will provide a stark contrast to the panic and value destruction that some investors are currently experiencing. Certainly, shares in some NZX listed companies are looking more attractive now than they did at the beginning of 2020.

Finance is clearly an important facet of M&A, and although banks will not be short on capital (especially with the recent deferment of the introduction of increased capital adequacy rules), we expect them to become more careful with their lending decisions. This could present opportunities for non-bank lenders to provide alternative sources of capital, including new players who are private equity-driven—although memories of pre-GFC will remain raw for a large number of people.

The northern hemisphere economies will head into summer months soon and provided that they manage to curb the spread of COVID-19 (as some Asian nations have begun to do), would be hungry to make up for lost ground and capitalise on favourable currency exchange rates. In that regard, we expect Asian investment in New Zealand assets to become increasingly active. NZX, the Financial Markets Authority and the Takeovers Panel have recently provided (or announced that they will provide) temporary reliefs designed to enable businesses to access capital urgently in these unprecedented times – and we could also see the Overseas Investment Office introduce certain supporting measures to make foreign investment into New Zealand easier, with a view to stimulating growth and optimism. However, in an election year, foreign investment risks becoming a political, rather than commercial, issue, and any such supporting measures would need to be carefully thought through.

If you would like to discuss any of the themes in these predictions please contact any of our experts:

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