

“M&A prospects for next year are good”



Interview with

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Following the slowdown caused by the Covid-19 pandemic, M&A activity is moving towards a ‘new normal’ where the market will rebound, say Araoz & Rueda partners Pedro Rueda and Israel de Diego.

LEADERS LEAGUE. How has COVID-19 affected the M&A market?

Pedro Rueda. We are witnessing an unprecedented crisis, and the final effects are still to be seen. On the economic side, the crisis is severely affecting sectors closely linked to the leisure & entertainment (films, theaters, movies, concerts), tourism (hotels, restaurants, cruise lines, travel agencies), transport (airlines, coach and railroad operators), retail and automobile industries.

After the period of intense activity in recent years, the crisis and uncertainty triggered by the pandemic have caused a standstill in the M&A market worldwide, especially in the second quarter of 2020.

And although the M&A practice, especially in the mid-market, has not been so badly affected – mainly thanks to ongoing transactions and the surge in activity in the renewable energies sector, the reality is that transactions fell in March and April, both in number and value. The lenders reduced their lending activity and focused on existing financing – sellers stopped exits and purchasers put on hold ongoing transactions.

Has the economy recovered more recently?

Israel De Diego. Since May, the recovery in M&A activity has been remarkable and the prospects for the rest of the year and next year are good. It seems to be a unanimous view that the situation caused by Covid-19 is temporary and an economic recovery is expected when the situation stabilizes when vaccines are developed. This will lead to a gradual reactivation of the markets.

In addition, unlike the financial crisis of 2008, investors have a lot of dry powder and a willingness to invest. Moreover, lessons learned in the past have enabled management teams to react quickly. In recent months we have seen how local investors – in response to the risks arising from the pandemic – have adopted defensive positions focused on protecting existing portfolios and investing in sectors that have proved to be less cyclical and more resilient. Now it is time to act.

Therefore, at Araoz & Rueda, we are optimistic and are convinced that the M&A market will continue picking up after the Covid-19 plunge, especially in the context of local transactions, and will return to a level of normality in the coming year with the re-entry of international investors, who were less active amid the uncertainty of recent months.

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The investor’s and transaction profiles are also expected to change slightly. Private equity will play a major role in future investments thanks to the accumulated liquidity. Industrial investors will also be active with opportunistic growth transactions in view of the potential opportunities arising in their respective sectors.

What assets will attract investors in the coming months?

P.R. Targets will very much depend on the investor's profile, although the main beneficiaries will be the health, technology, logistics and online (online learning, online retail platforms, online delivery) sectors. Thus, the largest funds with the greatest financial muscle will probably be more flexible and will invest in sectors that have been most affected by the crisis - this will enable them to achieve a higher return and even, in some cases, make acquisitions with discounts. On the other hand, smaller funds are likely to be more conservative and will focus on companies that have best weathered the crisis. After years of intense activity, investors are also finding themselves with mature portfolios to exit. However, exits are unlikely since funds have been forced to postpone their divestment plans. This is for three main reasons. Firstly, losses accumulated by subsidiaries as a result of the crisis have affected returns. Secondly, because of the lack of financing. And thirdly, because the management teams of the subsidiaries are more focused on tackling the crisis and ensuring the viability of the companies rather than on managing a sale process.

On the acquisition side, things are different. The volume of new investments will grow, especially in the coming year. The current environment offers investors a great opportunity to explore new business lines and also strengthen and consolidate existing ones with the so-called bolt-on or build-up acquisitions. The crisis will mean that companies that may not have been planning a sale before the pandemic may now go down this route in an effort to escape the current difficulties.

We also believe restructuring and reorganizations (such as mergers, spin-offs and carve-outs) will increase in the coming months, as businesses look to reduce costs.

What will be the impact on company valuations in the coming year?

I.D.D. In terms of company valuations, we don't expect much change from what we have seen so far. We will see opportunistic acquisitions involving companies affected by the crisis - especially as the aid mechanisms introduced by the government (ICO lines, temporary layoff procedures ERTes) and financing come to an end. Also, companies with better results, and which represent more secure value for investors, will be attractive to investors that are willing to accept lower returns in exchange for less risk, especially in view of the low interest rates available. However, caution is advised. It is difficult to say how the markets will behave in the short and medium term. Despite the lessons learnt from past crises, the triggers for the current crisis are very different. It is worth mentioning that the main problem for M&A in recent months has been uncertainty - including second waves (even third waves), legal uncertainty, labor and fiscal counter-reform, Brexit and elections in the US, and tariff negotiations with China.

What is clear is that Covid-19 is here to stay for much longer than initially expected and will have long-term effects, even after the long-awaited vaccine is developed. The key to the recovery of the M&A sector will be to combine the lessons learned from the past with a proper recognition of the challenges ahead. ♦