M&A TRENDS

Active market highlights buyer selectivity, seller preparation

Fewer purchasers might seem like a bad sign for sellers, but in an accelerating mergers and acquisitions (M&A) market for specialty chemical operations, quality over quantity is increasingly becoming the focus. Experts say that the M&A market has been frothy and deal flow is continuing to rise. This has resulted in buyers being more selective and has made upfront decisions about what deals they want to pursue hard - whereas before they may have chased a few knowing there would be some degree of attrition. In many instances this can be a good thing for a seller, as it can result in less speculative scouting from a buyer and more intentionality.

Such were the themes that emerged from the M&A Valuation Panel discussion at the Specialty & Custom Chemicals Show in Fort Worth, TX.

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In-person vs. virtual

2021 was a historic year in M&A, particularly within specialty chemicals – both in terms of volume of deals and valuations. While the market remains robust, the process by which deals are completed has fundamentally changed over the last 24 months.

With 12 years of experience under his belt in dealing with mergers and acquisitions at three different companies, panel moderator John Zuppo, Executive Vice President at Synalloy, has personally witnessed the transition from in-person to virtual transactions. This has impacted trust, relationships, credibility, capability and attention.

"The pandemic changed the M&A process," said Zuppo. "Before COVID, fireside chats were conducted in person, whether in the Americas, Europe, or Asia. Then, suddenly, everything flipped to a near 90% virtual setting, causing the process to become more robust and response times more compressed."

Kevin Yttre, President and Managing Director of Grace Matthews, agreed, adding, "I hope the advisory process goes back to being mostly in person because what you don't get from an on-screen interaction is an in-depth personal connection and trust building that is more readily

attainable when together face to face with someone. Those seemingly small, nuanced interactions are a valuable aspect of meeting in person."

Fewer but better buyers

Bob Girton, a Partner with Edgewater Capital Partners, said, "While a lot is different today versus before March 2020, in many ways, the pandemic really just accelerated trends that were already there.

"Initially, early 2020 saw everything go dormant while we tried to work through and understand the implications of COVID. Edgewater had two or three opportunities that died late in 2020 due to uncertainty; though, by the final quarter of the year, everything was back up and running, especially for businesses that had weathered or performed through the pandemic."

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In 2021, the specialty chemicals M&A market saw a rush to sell. "Good, bad or otherwise, businesses came back into the market," continued Girton. "Potential changes to tax law only added fuel to volume. This meant M&A executors were above full capacity. We shifted from a historically high number of bids to selecting a critical few very early in processes and running extremely fast activities. As a result, processes are narrower now and the market is increasingly efficient."

With that, Girton explained that it takes fewer bidders to ensure a "...market clearing price. Also, terms are becoming more standardized, especially with the rise of representations and warranties insurance."

Yttre agreed. "We are seeing fewer but better buyers; people leaning in harder, rather than lobbing in bids to see what sticks. Buyers are playing to their strengths and being much more selective."

Girton noted, with a smile, "just to be clear, we never 'lobbed in bids.' We have in the past allowed the process to self-select. And now, we are being even more thoughtful much earlier." In the expectation of being among the finalists, he added, "we think, how do we win a tie?"

Part of being selective is digging deeper into the prospective company's profitability, not just looking at the top-line number. "Many operations are seeing increased volatility in their profitability these days – in some cases positive, in others negative," Yttre noted. "We're asking the question of why? Are the current numbers sustainable, or are they a one-off reflection of the current environment?"

Girton readily agreed. “We are picking up early in the process of whether there is noise in the story, and if so, just moving on. Competitiveness is here to stay. Narrowness in the process is also here to stay.”

Importance of growth and leadership

Beyond the numbers, it is important to assess the full scope of a team, Girton added. “That is becoming more difficult in a highly competitive market. In that sense, a carve-out may actually be easier to quantify,” because the operations are the essence of the transaction. “In a transaction involving the whole company of an owner-operator, the picture can be harder to discern.”

Another important element in the overall picture is breadth of leadership. “Leaders that possess wider ranging backgrounds are becoming increasingly rare,” said Girton. “It used to be that top executives would have punched their tickets in different management areas, including operations, sales and so forth. Now it seems that most of the senior people just come up through one silo. Assessing management completeness and how to hire or build around that is a vital factor in the process.”

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At the same time, owner-operators have decisions to make as well, Yttre noted. “There have been cases where we have sold companies to the third- or even fourth-highest bidder – in a tight range, to be sure – because a buyer’s message and/or vision for the company’s development really resonated more with the owner than other buyers’ plans. Owners want to be paid, but many also want to make sure that they are leaving the business in the best hands possible.”

In any case, the onus for telling that story, and helping buyers make those discernments, is on the seller. “There is some perception these days that sellers may be less prepared,” said Yttre. “It is true that there is so much value in the preparation work that is done by the sellers. And we also recognize that some find it difficult to let people (employees) into the tent.”

Continue to operate your business like you’re not selling

Another insight Yttre offered is that a transaction can sometimes start to overshadow the operation. “It is important for owners to continue operating the business as if they were not selling,” he said. “Yes, it takes preparation for the transaction, but don’t let that distract from running the business.”

Preparation includes both paperwork and personnel, Girton added.

Expanding on Girton’s earlier comments about how new conditions in M&A are here to stay, Yttre suggested “there is likely to be more activity in the back half of 2022 and into 2023. We are now seeing who is actually able to sustain their recent successes,” and that is likely to continue to fuel buying interest in the top performers.

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