

M&A deals and risks will keep rising

Our survey reveals M&A trends
and recommendations



The past year has seen a continual surge of M&A deal volume, and the peak might still be ahead.

“We are in a massive surge of activity, because companies have recovered from the impacts of COVID-19,” said Grant Thornton Mergers and Acquisitions National Managing Principal Elliot Findlay.

Findlay said a few factors are helping to drive the surge. “We know private equity has record levels of capital from recent fund raising. Also, the exhaustion from COVID-19 has some private business owners saying, ‘We weathered the storm, but I don’t want to do that again – let’s take some money off the table.’ Plus, the changing tax landscape for capital gains has created anxiety with most private business owners, especially those that are nearing an exit in the next few years.”

In a recent survey of M&A dealmakers, Grant Thornton found that there is a clear consensus on some key expectations for the future. Respondents believe that deal volume is likely to keep growing, and they expect valuations to remain high – or get even higher.

High valuations will be driven by the appetite for deals, but also the ongoing increase in special purpose acquisition companies (SPACs) and earnouts.

At the same time, dealmakers anticipate the rising volume will come with rising disputes. To prepare for disputes and form the right deal structure, it’s important to recognize evolving M&A trends.

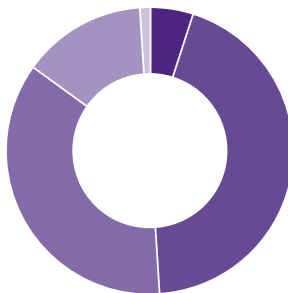
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**Elliot Findlay, National Managing Principal,
Mergers & Acquisitions, Grant Thornton**



Compared to the past six months, how do you expect deal volume to change in the next six months?

- Significant increase..... 5%
- Increase..... 44%
- Stay the same..... 36%
- Decrease..... 14%
- Significant decrease..... 1%



Deal volume will grow

Survey respondents included 44 C-suite executives, 39 private equity leaders, 40 investment bankers and 40 attorneys. A full 85% of these respondents expect deal volume to stay the same or increase over the next six months. A planned [increase in capital gains](#) taxes will spur private owners to close deals before the end of 2021.

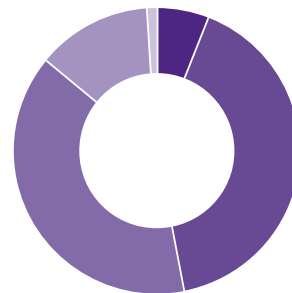
The survey also indicated that the [technology](#), retail, hospitality and insurance industries are likely to see the most volume.

Retail, hospitality and other industries hurt by the pandemic might also have activity outside of traditional M&A. “There are a lot of investors looking at retail, hospitality and real estate as a way to pick up assets that are potentially undervalued,” said Grant Thornton Corporate Finance National Managing Principal Paul Melville. “The deals in that space are often distress deals that might not fall into normal M&A activity.”

The appetite for new deals will keep driving high valuations – but other factors will push valuations as well.

How do you anticipate valuations changing in the next six months?

- Significant increase..... 6%
- Increase..... 41%
- Stay the same..... 39%
- Decrease..... 13%
- Significant decrease..... 1%



Valuations will stay high

In the survey, 86% of respondents indicated they expect to see valuations stay steady or increase in the next six months.

“It mirrors the level of activity,” Melville said. “It’s a matter of supply and demand, and the availability of capital. People with significant capital are looking at a limited number of targets, which is going to drive prices up.”

Findlay noted, “This is all for the right company, for the right industry – I wouldn’t say it’s a shift across the board. There are companies that have weathered COVID-19, came through strong and have shown a high degree of business resiliency.”

Given the right opportunity, many buyers can find the cash. “With the indications we are seeing, people are feeling very bullish, and bankers are making commitments on what business owners can get,” Findlay said.

Along with the available cash and appetite, two current M&A trends are driving high valuations: SPACs and earnouts.



SPACs and earnouts will continue

The increased use of SPACs to acquire companies means more competition. “SPACs are buyers – there’re additional buyers in the marketplace – and so that really drives up multiples,” Findlay said. “Plus, SPACs have a timeline by which they need to transact.”

Even in spite of the SEC’s [crackdown on SPACs](#), 89% of survey respondents predict the SPAC trend will continue or grow over the next year.

“Despite the SEC taking action to discourage SPACs, our respondents still believe that SPACs are here to stay,” Melville said.

Another trend that’s sticking around is the increased use of earnouts in deals.

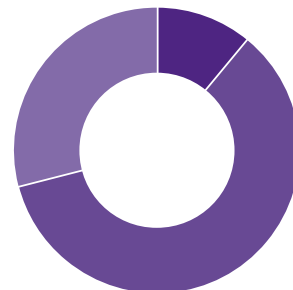
Nearly all survey respondents (a total of 94%) said they expect to use earnouts in at least 70% of their deals over the next six months.

“The volume of respondents expecting 90-100% of deals to have an earnout is staggering,” said Grant Thornton Purchase Agreement Advisory Leader Max Mitchell. “If they’re right, then most every deal will have an earnout by the end of the year.”

“I would say that earnouts are up because there was some unbelievable performance – there is a lot of skepticism in the marketplace based on performances, and a lot of anxiety generally,” Findlay said.

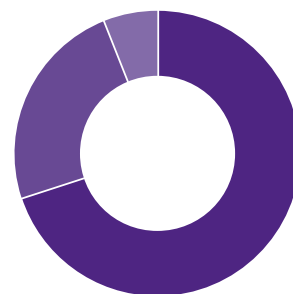
Which of the following statements most accurately reflects your view about SPACs?

- The SPACs trend has peaked already and will disappear as quickly as it became fashionable..... 6%
- SPACs have reached their top popularity but are here to stay..... 60%
- The SPACs trend is only at the beginning and the number of SPAC deals will grow significantly over the next year..... 29%



What percentage of deals do you expect to have an earnout component in the next six months?

- 90-100% of deals will have earnouts..... 70%
- 70-80% of deals will have earnouts..... 24%
- 0-50% of deals will have earnouts..... 6%



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**Paul Melville, National Managing Principal,
Corporate Finance, Grant Thornton**



“There’s so much uncertainty in the market, and earnouts are a way to mitigate that uncertainty,” Melville said. “If you’re not certain about what the future’s going to be, put an earnout in because, that way, you use the natural hedge of performance to impact the ultimate price. Prices are high, but that’s because they’re hedging by putting in earnouts – so, they may be paying ten times but in reality, once the deal closes and there’s a problem with the earnout, they only pay five times.” Some of the earnouts are also from buyers giving credit for COVID EBITDA adjustments in overall valuation, but including that portion as an earnout to protect themselves.

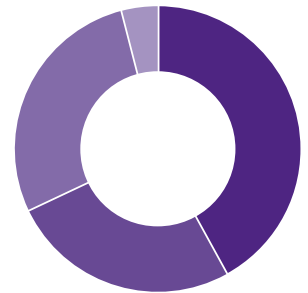
Of course, post-close price adjustments are fertile ground for disputes, and poorly structured earnouts are often at the center. “If an earnout is not clearly detailed in a purchase agreement to the nth degree, there are a lot of challenges,” Findlay said.

Disputes will continue to rise

Our recent [M&A dispute survey](#) focused on the trends and causes behind disputes, noting that the overall volume of disputes was on the rise. Extending those predictions, respondents to this survey anticipate that disputes will keep rising.

Compared to your deals closed in the run-up to the COVID-19 outbreak, how has the volume of disputes changed?

- Significant increase in deals that have been disputed..... 42%
- Slight to moderate increase in deals that have been disputed..... 26%
- About the same..... 28%
- Slight to moderate decrease in deals that have been disputed..... 4%
- Significant decrease in deals that have been disputed..... 0%



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Grant Thornton Forensic Advisory Services Managing Director Charles Blank said that earnout disputes usually arise where a seller may contest the buyer's GAAP accounting or contractual definitions of the earnout metric, such as EBITDA. However, more recently, sellers have been challenging whether COVID-related adjustments should be made to the earnout metrics reported by buyer. Blank also indicated that many of the earnout disputes coming to light now relate to transactions that closed prior to the pandemic and did not have specific provisions to address business shutdowns.

"With so much value locked into the earnouts, there is additional buyer and seller consideration of what's at stake," Blank said. "But still – as was the case pre-pandemic – there's not always enough detail in how earnout metrics are calculated post-closing."

"We still see vague definitions and unclear drafting regularly. We are consistently working with clients to more accurately detail what gets measured – and consider the 'why'" Mitchell said. "EBITDA is the most common metric by far – but we ask 'why?' Why measure EBITDA – is that indeed the primary focus post-close? Or is it sometimes the revenue, customer retention, ongoing employment or some other factor? Might any of those be better metrics to consider and possibly lead to fewer disputes?"

"If they do use EBITDA – then calculating it 'consistently with historical practice' won't always consider upcoming changes in GAAP, new circumstances that did not historically exist, or future 'one-offs' and the effect they may have. In all cases, set up detailed accounting hierarchies and specific policies. Proactively consider what might happen in the one, two, three or more years post-close that will need to factor into these calculations," Blank said.

Many deals are drafted to allow for immediate signing of an agreement, but can lead to conflicts down the road. "Rather than putting a value on any uncertainty now, deal advisors are taking a 'wait and see' approach by using earnouts, but in doing so they often risk pushing a dispute or value debate to 2022 and beyond," Mitchell said.

The future is full of new factors

As M&A deal trends keep evolving, other factors will soon come into play.

"Think of what's happening with [ransomware](#), new market uncertainties and geopolitical disruptions," Findlay said. "One of the things that's important to note is there's been very little activity from foreign buyers, because of the ongoing wave of COVID-19 around the world."

"As we reach stabilization, there will be more international buyers entering the marketplace. I think once individual countries are stabilized, that will drive activity on international deals and expansion into other geographic markets. I anticipate seeing a lot more international buyers coming," Findlay said. In the US, supply chain risks, increased labor costs and the continuing evolution of automation and other technology are some of the factors that will keep shifting the landscape.

As factors keep evolving, it becomes even more important to ensure that [valuations](#), [earnout calculations](#) and other aspects of a deal are structured with foresight and responsiveness. By doing this work up front, parties can help [avoid dispute](#) and achieve success in an uncertain future.

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**Max Mitchell, Senior Manager and Leader,
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