Acquisitions are a topic of much contemplation and fear, but also of importance, for many companies and their owners.

There are so many layers to it!

The following are only some of the questions and concerns we have gleaned from our clients and personal experiences over the years, as advisors, principals and private company executives:

When do I buy another company?

How do I do it, exactly?

Where do I start?

What are the key steps?

How do I protect myself and my company?

Is this really a good idea? How do I know for sure?

Do I put my existing business at risk?

How disruptive will this process be?

Can I do it with my team, or do I need an advisor?

What are the costs of this process?

What are the timelines of this process?

Which of my employees do I bring into the loop?

Are the market conditions right for a deal?

Where do I go from here?

Over the next nine instalments, we will attempt to provide insights on many of these important questions.

We can't cover all the bases here, but hope we can illuminate the topic of acquisitions relating to private companies, and provide insights on areas for further examination.

(Selling your company and exit planning are a whole other topic, which we cover in another series available separately.)

Watch this space for upcoming instalments, and happy reading!

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Part 2 - Get the giants' attention with strategic mergers

Opportunity and imperative in chaos

By most accounts, a robust Canadian mergers and acquisitions market for small- to mid-sized businesses (SMBs) has been thrown into tumult with the direct and indirect impacts of COVID-19.

The overall uncertainty of consumer and business demand, future economic growth, employment levels, foreign exchange rate movements, trade policy, and debt levels across the spectrum, not to mention the operating models and cost structures of SMBs impacting their future profit margins, makes it a real challenge to assess deal risk and determine appropriate valuations.

And buyers' boards of directors' antennae are up today . . . way up.

But many buyers remain fueled by large cash holdings, low interest rates—and increasingly, the imperative to buttress slower organic growth with targeted acquisitions.

M&A activity continues to be buoyed by the activity of so-called "strategic buyers", as well as by continuing tough conditions in the initial public offering or IPO market (a key alternative to selling your company) outside the 'unicorn' IPOs of the likes of a Snowflake or Palantir.

It is unfortunate there is sparse data for the smaller end of the market to be more scientific and definitive, but here are some practical observations:

"Strategic" in the eye of the beholder. Today, strategic buyers are considered to be companies that buy other companies they consider directly and specifically complementary to their core business.

This would include broadening their product offering, geographical coverage, or core skill sets of staff and customer base, or serving their markets more fulsomely and/or more cost-effectively — not simply getting bigger for bigness' sake.

But the notion of what is "strategic" changes.

At one time, buying unrelated businesses as part of a conglomerate strategy was considered strategic—and will probably again be one day.

In the late 1990s and into the 2000s, companies of all sizes either bought or started ventures unrelated to their core business, either looking for returns on investment separate from and uncorrelated with their existing business to reduce overall blended risk, or simply goosing overall returns for the owners.

Many of these initiatives didn't end well, particularly as capital market conditions deteriorated for small to mid-sized businesses even before 2008.

Even today, the distinction between a "strategic" deal and a "buying to get bigger" deal is fairly fine. Frankly, if it is acquired cheaply enough, it becomes strategic to the buyer and its stakeholders.

Overall, buyers today are honed in on tuck-in acquisitions that enhance their core business in very specific, targeted ways, such as adding to their technology stack or in-house technical skills relating to such things as data analytics, remote work platform integration, and artificial intelligence.

Size matters. Size has a much broader and bigger impact on SMBs relative to large cap companies.

In today's markets, which 'size bucket' you fall into will help determine your probability of being acquired, or getting financing to do an acquisition.

(See accompanying scale below under "Bucket Sizes").

Bucket Sizes. *The typical size "buckets" for evaluation of SMBs break down as follows in terms of sales revenues:*

Early stage	*<=$1-million*
Emerging	*$1-million to $5-million*
Ramp-up	*$5-million to $10-million*
Expansion	*$10-million to $25-million*
Critical mass	*$25-million+*

The type of buyer or investor who may be interested in your company will also change materially as you move from bucket to bucket.

This will also drive what valuation methodology will be used.

So, a deal that moves an SMB from one bucket to the next may be "strategic" for that reason alone, and not empty empire building.

As a general rule, you will get a better relative valuation (i. e. multiple of sales, earnings or cash flow) as you move up the scale. The same is true for the probability of selling your company or getting financing to do an acquisition.

This is by necessity a simplified picture, as each industry will have its own unique features and considerations, but the overall paradigm holds broadly.

Whether any deal is truly "strategic" will be specific to each SMB.

Raising the bar. Another important trend expected to continue to boost the volume of M&A activity for SMBs is the increasing quality of targets.

First, many of the weakest companies have either done distress deals or disappeared in recent years, and this is expected to accelerate in the COVID-19 era.

Second, overall SMB market valuations are looking like more and more of a steal compared to the relatively robust, even skyrocketing, valuations in the large cap space.

Valuations have thus tended to improve steadily in recent years, and hold up fairly well during COVID-19 for top-quality SMB targets, which has and will continue to bring more high-quality companies into the market, helping create supply for the growing demand.

Third, with the passing of time, more and more good companies and their owners will lose patience with waiting for things to get better and lower their expectations.

Expectations are very sticky for SMB owners on the downside — it is an effect of the unceasingly bullish sentiment that motivates and drives entrepreneurs. This is a much stronger and more influential factor for this segment than for the large cap players.

New consolidation plays. Another element having a major impact on M&A activity in this segment is the acceleration of the consolidation curve in a number of market segments many SMBs are in, and technologies they represent.

Software-as-a-service (or indeed everything-as-a-service), cloud-computing technology, security, mobile technology, digital media and entertainment, and consumer devices come to mind. These segments are led by cash-rich and increasingly acquisitive giants including Alphabet, Facebook, Apple, Amazon, Oracle, IBM and others.

The giants are becoming increasingly broadly integrated, and are hollowing out the medium-sized segment of the corporate world as they seemingly scoop up everything to become one-stop-shops for their own customers, and to go after everyone else's.

All this leaves an opportunity for SMBs to follow their own growth and acquisition strategies:

Namely, to move into the increasingly vacant middle ground to become big and interesting enough to be acquired by the giants, if they are not currently sufficiently attractive targets.

Consolidation plays have existed for years in both the technology and traditional business segments, but the paradigm is on steroids these days.

Conclusion – Opportunity and imperative in chaos. While M&A deal volumes and valuations in the SMB segment are much more volatile than for the overall market, bottom line, these companies have a good opportunity to define their own opportunity to benefit from these and other plays.

The key more than ever is attention to detail, and not fighting the prevailing trends.

Swim with the tides.

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