**A picture containing drawing

Description automatically generated**

**COVID-19’S IMPACT ON M&A IN THE TRANSPORTATION & LOGISTICS SECTOR**

By:

Nikhil Sathe  
Managing Director – M&A Advisory  
Armstrong & Associates, Inc.

Throughout January and February, financial markets seemed to be resilient against the fallout from COVID-19, the disease caused by the novel coronavirus. Some market participants thought that the virus could be confined primarily to China or that countries with a strong healthcare system would not be hit as hard. Or, even if the disease were to become a global pandemic, they expected that markets would react the same way they did in prior virus crises like SARS and MERS: with a small dip followed by a quick rebound. By early March, it was clear that the COVID-19 crisis would play out differently. The financial markets are now pricing in significant fallout from COVID-19 on the global economy and a resulting recession.

It is already impacting current and future merger and acquisition (M&A) deals. The markets do not like uncertainty and volatility, and we can’t escape significant headwinds compounded by stay-at-home orders and a global shutdown. The Industrial vertical industry has been hard hit in the last 30-45 days and this uncertainty will continue for some more months.

Debt accumulation, business survival and recovery, employment, immigration, housing, and energy prices have been impacted heavily from the current economic situation. We are falling into a deepening recession over the coming months as consumer spending and manufacturing output are adversely impacted. We are reading, in disbelief, about negative oil prices as supply far exceeds reduced global demand.

First and foremost, corporations are focused on keeping their employees and businesses safe in these turbulent times. Amid increasing uncertainty, however, many corporate leaders are being asked to make strategic decisions. For example, should they call off a transaction that has been in the preparation stages for many months or push it through to completion? Has the plunge of more than 30% in equity markets created buy-side opportunities? Against this backdrop, we look at **the** **current state of the transaction market in the Transportation & Logistics Sector** and offer advice on how dealmakers should proceed.

Turmoil in capital markets is often a forerunner of what happens next in the real economy. The most affected countries will experience a recession this year. For Germany, Europe’s largest economy, the Ifo Institute for Economic Research expects GDP in the second quarter of 2020 to decline by 4.5% compared with the first quarter and forecasts that it could contract by 1.5% this year. And the U.S. has already fallen into a second quarter recession by many accounts. Additionally, historical data indicates that a bear market for the S&P 500 signals an 80% chance of a recession. This is also a consumer-led recession, and given the uncertainty of this virus and lack of medical intervention or a vaccine soon, this uncertainty will continue even after the first wave has tapered off.

The severity of the short-term effects on the M&A market is already evident in the fact that numerous deals have been paused or delayed in recent weeks. For example, a number of our buy-side and sell-side deals have been back on the negotiating table for a variety of reasons from inability of securing leverage debt financing, valuation, deal structure and significant market uncertainty in 2020.

Armstrong & Associates is predicting that 2020 will look similar to 2009 when 3PL revenues dipped significantly. Based on our research, A&A estimates 3PL revenues in 2020 will decline 2-5% over 2019. 3PL market segments with longer-term contracts and e-commerce business are faring better than those relying on spot-market pricing. On the other hand, we are also talking to numerous financial sponsors and family offices flushed with significant dry powder. These financial buyers are keen in doing deals in the Transportation & Logistics Sector (especially with asset-light models) as this sector continues to attract investors with its attractive IRR (internal rate of return) and historical strong and secular trends.

UK-based Cineworld’s proposed acquisition of its Canada-based competitor Cineplex was announced in December 2019 and approved by shareholders in February 2020. Since then, however, the share prices of both companies collapsed amid concerns that the cinema business might dry up during the crisis. As a result, investors have started to wonder if the deal could fall apart. Similar issues have risen recently in many financial investor-backed transactions in which promising bidders, such as Cinven and Goldman Sachs’ private equity arm, dropped out of bidding processes. The withdrawals were partially due to COVID-19-related concerns and changing deal circumstances, such as altered business plans. At the same time, many companies are likely to postpone their not-yet-announced acquisition plans, owing, for example, to the financing difficulty and contract negotiation complexity created by the crisis.

We expect Strategic Buyers to be more active in 2020 in the T&L sector as these companies are more opportunistic about accretive deals and the need to execute their long-term growth strategies. A&A’s restructuring and turnaround practice has gained momentum as a result of COVID-19 as small to medium asset-light businesses need assistance navigating through this crisis as the market is deeply fragmented.

**WHAT SHOULD DEALMAKERS BE THINKING ABOUT?**

When dealmakers are ready to focus again on their core pursuit, they will have plenty to think about. For companies that have built a healthy balance sheet during the economic boom of the past ten years, declining valuations create opportunities to pursue deals that create long-term value. Our experience demonstrates that deals done during weak economic times create significant value for the dealmakers and their shareholders.

Lower valuations are not the only reason that weak-economy deals outperform. In a public takeover, the discount when acquiring targets might be lower than expected because shareholders demand significant premiums. During the Great Recession, for example, premiums jumped substantially above the long-term average of approximately 30%. Assets currently owned by corporate or private equity investors will probably see higher-than-average premiums, at least to some degree.

**There is a more fundamental reason why acquisitions in weak economies create value:** A company can take advantage of the environment to execute its strategic acquisition agenda and to position the business for above industry-average growth once the economy recovers and accelerates out of the recession. Additionally, a company can focus on integrating the target during the downturn—when competitors are busy trying to survive—and then fully benefit from synergies in the recovery.

**WHAT ARE THE WINNING STRATEGIES?**

Based on A&A’s experience, there are several winning strategies for transactions in a weak economy:

* **Look beyond your core business for Synergistic Deals:** While acquiring targets in your core industry during a downturn creates value, you can benefit even more from non-core acquisitions.
* **Be creative about your deal structure:** Ideas like extended closing and creative, “think outside the box” approaches such as innovative earn-out models, could be winning strategies.
* **Learn from experienced dealmakers:** Acquirers that regularly engage in M&A, earn returns from deals made during downturns that are five times higher than those earned by occasional dealmakers. In the current situation, experienced dealmakers can fully leverage their well-honed, structured approach. A&A’s domain expertise can assist in quality operational due diligence which assumes greater importance at this time. This means conducting a focused due diligence process (without being distracted by external crises), deploying scenario planning in order to be prepared in a fast-changing environment, and rigorously integrating targets to jump-start value creation.
* **Don’t take value creation for granted:** When acquiring underperforming assets during weak economic times, even experienced dealmakers create value in only half of their deals.
* **Consider de-risking your M&A strategy:** If your industry is being hit hard by the current crisis, consider deploying tools other than outright M&A. Forming strategic alliances, for example, could be a way to resolve short-term supply chain issues.

Additionally, corporate decision makers can take several concrete steps today:

* **Prepare:** If you don’t have a wish list of targets that fit your strategic agenda, think about developing one now. There might be buying opportunities soon.
* **M&A opportunities are not found, but are often developed:** A&A can help you find those targets in a non-auction, mid-market environment as buy-side market leaders supported by our robust database and deep network relationships.
* **Don’t panic:** Now is probably not the time to shed assets, potentially at fire-sale prices—even if investors might appreciate spinoffs and divestitures in the short term. In the long term, panic selling does not create value. In any case, the window for IPOs and other forms of divestiture has closed.
* **Be bold:** The current situation might tempt you to stick with what you know. But the bold dealmakers utilize downturns to get ahead of the curve and come out stronger.

Corporate decision makers have no tried-and-true playbook to navigate these unprecedented times with this healthcare crisis of our generation. A certain amount of improvisation will be required to survive the crisis and accelerate out of the eventual recovery. For companies with strong balance sheets, M&A will play a major role. Preparation, steady nerves, and a willingness to be bold are the keys to success.

Although capital markets are reacting cautiously to leverage debt financing, we have a reason to believe that there is significant dry powder available to be deployed in accretive assets. We believe the U.S. and Canadian economies have shown resilience to bounce back. The question is, “How will the consumer react to the ‘Next Normal’ after the COVID-19 wave is tapered off?” Let’s hope for the best!