CHRIS MANDERSON, MICHAEL PIRIC, MICHAEL B. SARYAN AND DAN SHEA SHARE INSIGHTS ON THE PRIVATE EQUITY AND M&A LANDSCAPE

The **Private Equity and M&A Strategies Roundtable** is produced by the LA Times Studios team in conjunction with Concord Legal Group, PC; Ervin, Cohen & Jessup LLP; Lincoln International; and Objective, Investment Banking & Valuation.

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After the many unprecedented operational changes that businesses in every sector had to make over the last three years, new factors continue to arise in terms of managing private equity or taking the plunge for a merger or acquisition. The economic climate has also forced companies to make changes to the way they do business and the way they approach their fiscal needs.

To address these issues and uncover the latest trends in the management of private equity and the merger and acquisition landscape, the LA Times Studios team turned to four uniquely knowledgeable professionals for their thoughts about the most important "need to know" insights and to get their assessments regarding the various trends that they have been observing in general.

Q: WHAT IS THE CURRENT STATE OF THE M&A LANDSCAPE IN 2024?

A: Piric

Deal flow didn't reach anticipated levels by the end of Q3, and this trend is expected to continue in Q4. At Lincoln, we anticipate that transactions closing and lower interest rates will stimulate increased deal flow in 2025. "Deals beget deals," underscoring sellers' preference for valuation proof points over price discovery. Without deal closures, comparable transactions are lacking, complicating sellers' adaptation to new market conditions. Successful deal closures will encourage sellers to bring their deals to market. Additionally, further interest rate cuts by the Fed are anticipated to positively influence valuations and market sentiment, fostering the belief that the market downturn is behind us and acceleration is imminent.

A: Shea

Overall, M&A continued to face headwinds in 2024, particularly in the first quarter, with deal volume and valuations remaining somewhat lower than historical averages. However, the tide appeared to turn in the second and third quarters, with deal activity shifting modestly upward. Further adding to the story, inflation and interest rates have declined in recent months and should result in additional deal volume gains in the fourth quarter, particularly once the national elections are behind us. Lastly, we sense that PE firms' eagerness to invest is growing, in part due to the aging of uninvested capital pools, which will give a lift to M&A activity beyond 2024.

Q: WHAT ARE SOME TYPICAL REASONS WHY DEALS FAIL?

A: Saryan

Lackluster performance of the target while the deal is pending is one of the most common reasons deals fail. M&A is time-consuming for the target's management and can distract management from running the business. However, it is crucial to ensure that equal attention is given both to the pending transaction and to continuing to operate the business. Buyers are actively engaged in due diligence until the deal closes. If the target's performance declines, buyers can get cold feet. Sellers should never let their vigilance in running the business dwindle just because a deal is pending. As the adage goes, a deal is not closed until it's closed.

A: Manderson

Deals fail both before and after closing. Typical reasons they fail before closing include diligence disasters, weakening target performance, litigation, negative market conditions, and denial of regulatory approval. Deals that fail after closing can be worse (for the acquirer), and post-closing failure is far more prevalent than buyers want to believe. Common causes include overpayment, excessive acquisition debt, management succession failures, poor synergies, and over-estimation of efficiencies. More often than not, poor integration is the cause of failure. Two disparate cultures, management systems, leadership teams and even back office systems cannot be easily merged.

Q: WHAT IS YOUR FORECAST FOR M&A ACTIVITY VOLUME FOR THE NEXT FIVE YEARS?

A: Manderson

M&A cooled significantly in 2023-2024 with interest rate hikes and Lina Khan's tenure at the Federal Trade Commission. Under Khan, the FTC aggressively scrutinized technology industry acquisitions by Meta (Within Unlimited), Amazon (iRobot-Roomba), and Microsoft (Activision Blizzard), as well as other deals such as Kroger-Albertsons. Regulatory uncertainty and delay have stifled M&A exits in tech and had downstream effects, especially in the technology investment ecosystem, keeping investments illiquid and stifling new investments.

A: Saryan

As interest rates drop, M&A appetites grow. Both PE firms and large companies have been sitting on cash and enjoying a decent yield on that cash. Buyers have expected higher returns from M&A targets in the last couple of years given the higher risk-free rate of return on idle cash. This has caused valuation multiples to decline, leaving sellers reluctant to sell in a down market. As interest rates are now trending down, cash on the sidelines needs to be deployed to yield a return, and valuation multiples will begin to rise. Both buyers and sellers will increase their appetites for M&A transactions, so the next five years will likely be an M&A boom.

A: Piric

Overall trends point toward M&A activity growth over the next five years due to pent-up demand from slower activity in 2022-2024; PE firms with portfolio companies to sell; businesses seeking inorganic growth to accelerate profits and transformation goals; pressure on companies to continue digitization initiatives and future-proof business models; and positive economic conditions.

Q: IN WHAT INDUSTRIES OR SECTORS ARE YOU SEEING THE MOST M&A ACTIVITY?

A: Saryan

Trade businesses in the home services space are growing in popularity as M&A targets, especially among private equity firms. These businesses are not going anywhere regardless of how technology advances. Although artificial intelligence has been a hot topic in the last year, it is still in its nascent stages so that sector is seeing a boom in venture capital funding but is not mature enough yet to see significant M&A activity. But as AI disrupts desk jobs, home services businesses like plumbing and HVAC continue to thrive and become attractive acquisition targets. We have seen growing PE activity in this space. As sophisticated technology solutions are now available to home services businesses, these companies are quickly growing from mom-and-pop shops to significant enterprises and seeing growing M&A activity, especially among PE firms that are scooping them up.

A: Shea

We're seeing strong M&A activity in several sectors, with particular momentum in Essential Services, Health & Wellness, and Aerospace & Defense (A&D). Essential Services has remained resilient, with deal volume stabilizing at pre-COVID levels, driven largely by private equity interest in recession-resistant businesses like environmental services and maintenance. Valuations in this sector have also stabilized, with EBITDA multiples averaging in the mid-7s. In Health & Wellness, activity is being fueled by demand for organic foods, personalized health technologies and omnichannel businesses. Finally, the A&D sector is seeing consistent deal volume supported by increased global military spending, especially in areas like MRO services and information technology. These sectors are proving attractive for buyers looking for stable growth and long-term value.

A: Piric

The most M&A activity is currently observed in the industrials and business services sectors. These industries are leading the charge due to their strong fundamentals and the ongoing need for consolidation to achieve economies of scale and operational efficiencies. For example, the industrial sector is seeing significant activity in areas, such as manufacturing automation and supply chain optimization, driven by the need to enhance productivity and reduce costs. Following closely are the technology, media and telecom (TMT) sectors. These industries are experiencing robust M&A activity due to rapid technological advancements, digital transformation and the increasing demand for connectivity and content. Companies in these sectors are pursuing mergers and acquisitions to expand their technological capabilities, enter new markets and enhance their competitive positioning.

Q: IN WHAT WAYS DO YOU ENGAGE WITH MANAGEMENT TEAMS TO ALIGN THEIR GOALS WITH YOUR INVESTMENT OBJECTIVES?

A: Shea

As sell-side advisors, we work closely with management teams to align their efforts with a successful sale. This begins with in-depth discussions to understand the company's value drivers, opportunities, challenges, customers, products/services, operations, team, financial history, growth prospects and certainly the desired outcome of the owners. For example, we recently advised a highly successful manufacturer whose success was primarily due to steadfast management focus on continuous product development and growing customer volumes. In part by emphasizing these key success factors with each prospective buyer, we were able to generate above-market offers and ultimately achieve an exceptional sale outcome for the owners.

Q: WHAT RECENT TRENDS HAVE BEEN HAVING THE MOST IMPACT ON THE PRIVATE EQUITY LANDSCAPE IN CALIFORNIA?

A: Piric

The projected lowering of interest rates, following the Federal Reserve's half-point rate cut in September, is expected to positively impact the private equity (PE)

landscape by increasing deal activity. Reduced interest rates lower borrowing costs, making leveraged buyouts more attractive and accessible. This environment encourages more transactions and can lead to higher valuations. Additionally, there is fierce competition for high-quality deals. Private equity firms are sitting on record levels of dry powder, escalating competition and valuations for premium assets. This trend is likely to persist as PE firms maintain a high standard on the buy side, focusing on businesses with strong fundamentals, growth potential and resilient cash flows.

Q: WHAT TYPE OF INFORMATION DO PROSPECTIVE INVESTORS ASK FOR AS PART OF DUE DILIGENCE THAT THEY DIDN'T ASK FOR IN THE PAST?

A: Manderson

Major new diligence issues include artificial intelligence, cybersecurity, compliance with new regulatory issues such as data privacy and security, the Corporate Transparency Act, geopolitical exposure with wars in Ukraine and the Middle East, and trade and security tensions with China. Buyers should be asking: can value be unlocked or destroyed with Artificial Intelligence? AI presents both risks and opportunities never before seen: Can the business they are buying be disrupted or made obsolete by artificial intelligence? Can it be made more efficient with AI?

Q: HOW WOULD YOU DESCRIBE THE PRIVATE EQUITY MARKET'S CHANGES OVER THE LAST COUPLE OF YEARS?

A: Shea

Over the past couple of years, the private equity market has experienced significant shifts driven by macroeconomic factors. Rising interest rates and inflation have increased the cost of capital, leading to more cautious dealmaking and lower valuations on average. At the same time, private equity firms are sitting on substantial dry powder, with record levels of uninvested capital waiting to be deployed. As a result, PE investors have shifted focus toward recession-resistant themes and sectors like Essential Services and Aerospace & Defense, while remaining careful and selective. Deal constructs have also evolved, with increased reliance on deal structure, including contingent consideration and, to a lesser extent, seller debt. Despite current economic challenges, the private equity market remains resilient, adapting to the evolving landscape while maintaining long-term growth potential.

A: Piric

PE has increasing dry powder, partly due to a slower M&A market and Investment Committees' focus on quality. As a result, PE firms are under pressure to deploy this capital efficiently, targeting resilient assets – businesses that demonstrate strong performance and stability even in uncertain economic conditions.
This preference for resilient assets is a strategic move to mitigate risks, ensure steady returns and ultimately be better positioned for fundraising. PE firms are conducting more thorough and rigorous evaluations of potential investments to ensure high-confidence outcomes. This involves greater emphasis on financial performance, operational efficiency and market positioning. Enhanced due diligence practices help PE firms identify and mitigate potential risks early in the investment process. We are noticing longer M&A transaction timelines as a result.
Deals that traditionally would have been financed in the public debt markets are now increasingly being funded via private markets. This shift is driven by the higher levels of dry powder among private lenders, who are eager to deploy capital. This trend has provided PE firms with more flexible and tailored financing options, enabling them to structure deals more creatively.

Q: WHAT CRITERIA DO YOU USE TO DETERMINE WHETHER A COMPANY IS A GOOD FIT FOR A BUYOUT?

A: Saryan

Good management, strong financials and a market sector that is either growing or stable. Good management is key. The same company can thrive or fail depending on who is managing it. Strong financials are an obvious must. The company has to be generating healthy revenues and profits, and it must be on a growth trajectory to be an attractive M&A target. Finally, regardless of the quality of management or past financial performance, the business must be in a market that is growing or at least stable. Technology can ironically be very disruptive to technology companies, so it is important to evaluate how technology may diminish a market to determine if good management can continue past performance in an evolving market.

Q: WHAT ARE YOUR STRATEGIES FOR EXITING AN INVESTMENT, AND HOW DO YOU TIME THE MARKET FOR MAXIMUM RETURNS?

A: Shea

We focus on maximizing value for our clients by marketing their businesses in a confidential manner to the highest and best suitors from across the globe, accentuating favorable and proprietary attributes and highlighting growth prospects and synergies with each prospective counterparty. It is a tailored process and one that honors critical but less quantifiable elements, such as team culture, the well-being of employees and the legacy of the company post-sale. Timing the market for maximum returns involves staying closely attuned to market dynamics, buyer demand and macroeconomic conditions. We monitor sector-specific M&A activity, valuation multiples and competitive landscape shifts to identify the ideal window for a sale. By helping clients prepare their businesses in advance, we ensure readiness to exit when market conditions are most favorable, resulting in optimal returns for our clients.

Q: AS WE MOVE DEEPER INTO 2024, WHAT ARE THE PRIVATE EQUITY HOT-BUTTON ISSUES AND WARNING SIGNS TO BE AWARE OF?

A: Piric

Sponsors agree that the anticipated post-Labor Day surge did not materialize as expected. With the slower M&A market, PE has primarily been focused internally, spending considerable time on portfolio company improvements and add-ons to ensure they will achieve the highest return when the market conditions strengthen.

Q: ARE THERE ANY NEW PRIVATE EQUITY VALUATION REQUIREMENTS THAT OUR READERS SHOULD KNOW ABOUT?

A: Saryan

You can never ignore interest rates and how they impact valuations by PE firms. Interest rates have an inverse correlation with multiples applied to a business to determine valuation. Why settle for a meager 8% return while taking risk when you can get a 5% return without risk? We saw rising rates in the last couple of years, so valuations dropped significantly. As rates continue to decline, valuation multiples will grow, and private equity valuations will also grow. The markets are always evolving and different factors impact valuation requirements, but interest rates will always have a fundamental impact on how private equity firms value a company.

Q: WHEN DOES THE INVESTMENT BANKER'S ROLE END AND THIRD-PARTY VALUATION BEGIN?

A: Shea

The investment banker's role is wide-ranging and includes deal strategy, preparing business profile presentations, buyer list development, confidentially marketing the business, facilitating due diligence, structuring transactions, and negotiations. Third-party valuation work pertains more to regulatory requirements, whether for financial reporting, tax compliance or regulatory scrutiny. Third-party valuation firms provide objective assessments, free from conflicts of interest, ensuring compliance with standards like ASC 820 (Fair Value Measurement for Funds/Portfolio Company Valuations) and ASC 805 (Purchase Price Allocation). Third-party valuations are critical for accurate portfolio assessments, carried interest calculations and meeting audit requirements. As regulatory environments become more stringent, particularly around fair value reporting, third-party valuations not only ensure transparency but also protect against potential liabilities and conflicts that could arise from in-house assessments. Relying on independent valuations gives stakeholders confidence in the objectivity and accuracy of financial reporting, which is becoming increasingly essential in today's regulatory landscape.

Q: WHAT ROLE CAN PRIVATE EQUITY PLAY IN SUCCESSION PLANNING?

A: Manderson

Selling a company can be an elegant solution to succession problems, which can be minefields more likely to lead to litigation and value destruction than success. The hit show Succession was fiction, but the foundation was based on dynamics often seen in real life. Family-owned companies often lack good succession options because 1) founder generations won't let go; 2) second and third generations can't or won't run the business; and 3) ownership is split among family factions, which fragment further with each generation. A sale of the company can solve succession problems, unlock wealth and keep the family peace.

A: Saryan

Private equity can play a huge role in succession planning. There was a time when an IPO was the dream liquidity event. Eventually, founders would retire from management and only sit on the board of the public company and hire professional management to run day-to-day operations while founders continue to reap the benefits. Now, as companies go public at a later stage and with significantly higher valuations, the private markets have become the new dream liquidity event. Founders now often look to grow a business until it is attractive to PE and then sell the company to a PE firm and continue to run it for a few years as it integrates into the PE firm's ecosystem. A large payday upon sale and a hefty salary for a few years to run the company has become the new dream retirement vehicles for business owners.

Q: IS INTERNATIONAL M&A ACTIVITY TRENDING UP OR DOWN?

A: Piric

International M&A activity is trending up. According to Mergermarket, M&A volume surged nearly 19% to $2.5 trillion in the first nine months of 2024, despite a small decrease in deal count. This is due to a number of factors, but a few we are monitoring closely include: (A) *Easing Interest Rates:* The reduction in interest rates has lowered the cost of borrowing, making it more attractive for companies to finance acquisitions. This has particularly benefited cross-border deals, where financing costs can be a significant consideration. (B) *Strong Stock Performances:* Robust stock market performances have increased the valuation of companies, providing them with more capital to pursue acquisitions. High stock prices also make stock-for-stock transactions more feasible and appealing. (C) *Economic Confidence:* There is growing confidence in a soft economic landing in the U.S., which has bolstered investor sentiment and encouraged companies to engage in strategic M&A activities. This optimism is reflected in the willingness of companies to invest in growth through acquisitions. (D) *Sector-Specific Drivers:* Certain sectors, such as technology, healthcare and renewable energy, are experiencing heightened M&A activity due to industry-specific trends. For example, the tech sector is seeing consolidation as companies seek to enhance their digital capabilities and expand their market reach. (E) *Geopolitical Stability:* Relative geopolitical stability in key markets has also contributed to the increase in international M&A activity. Companies are more willing to engage in cross-border transactions when there is a stable political and economic environment. (F) *Private Equity Involvement:* Private equity firms, with their significant dry powder, are actively pursuing international deals. Their involvement is adding to the overall volume and value of M&A transactions globally.

Q: WHAT TAX CONSIDERATIONS AND PLANNING EFFORTS SHOULD PRIVATE EQUITY GROUPS AND PORTFOLIO COMPANIES BE CONSIDERING?

A: Manderson

Private equity buyers should be as concerned about the seller's tax efficiencies in a deal as their own. In evaluating a sale, the seller will scrutinize their after-tax proceeds. A good tax structure can make or break a seller's desire to do the deal. But in general, after closing, private equity is less concerned with tax savings than with increasing EBITDA, which disregards taxes, because the value at exit will be a multiple of EBITDA. Also, private equity sponsors are often structured as Limited Partnerships, which pass through income to investors. Many of these investors are endowments and pension funds, which are not as tax-sensitive as operating companies. Finally, private equity fund managers make most of their income through carried interest, which is taxed at capital gains rates instead of ordinary income.

Q: WHAT ROLE DOES DUE DILIGENCE PLAY IN YOUR M&A STRATEGY, AND HOW DO YOU ENSURE IT IS THOROUGH AND EFFECTIVE?

A: Shea

Due diligence is a necessary part of any M&A transaction. Buyers need to independently investigate a target company and ensure to their satisfaction that they understand all relevant aspects of the business before closing can occur. In doing so, they often engage various advisory firms in the areas of accounting, tax, valuation, legal, operations, market research and environmental to prepare analyses and advice on an acquisition target. As sell-side advisors, we are adept at preparing management teams for these investigations and also in identifying, understanding and presenting the kinds of things diligence inquiry uncovers. In doing so, we know in advance what a buyer will eventually know. Advance notice is critical to a proper and thorough presentation of the business to buyers and allows for the promotion of favorable attributes and, at times, the mitigation of problem areas. This work in advance often requires that our client engage additional outside assistance, most commonly in the areas of accounting and tax.

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