

Sell or fight the 400lb gorilla: InterFinancial sees M&A market challenges rise

IN A RECENT report on Australia's mergers and acquisitions (M&A) landscape, specialists InterFinancial tracked the extreme challenges facing many of Australia's leading businesses trying to find direction "in choppy waters". Should business owners lower their expectations on business value for a sale now, or persist in spite of the risks of major competitors – so-called '400lb gorillas' – coming into their space?



The InterFinancial report noted Australia had traversed "a period of significant uncertainty and this has made decision making difficult". Reports from InterFinancial clients considering exiting their businesses found most did not expect the business environment to improve significantly in the next two-to-five year period – so they were faced with difficult decisions.

Should they sell at a price below previous expectations? Or should they continue on with the business and the related risks, banking the profits.

"We have recently met with two successful businesses facing significant change in their industry," said InterFinancial managing director Sharon Doyle. "Both have been finding trading difficult over recent years.

"Both are national leaders in their sector. They have both been approached by overseas category dominant players from Europe and the USA." These types of companies—often referred to as '400lb gorillas' have an enormous effect on a market when they enter.

"In the case of the first company they have held on due to the offer price being below their expectations. The large European company is now setting up a 'greenfield' operation," Ms Doyle said.

"If they are unable to do a deal the company faces the potential of gradual erosion of their business, much as the impact Bunnings has had on the corner hardware store.

"The second company is actively embracing their '400lb gorilla' from the USA. While they are being careful about dealing with them they are realistic about the effect they will have on their sector when they enter the Australia market.

"As part of this process they have had to revise their expectations on the value of the business."

Ms Doyle said the 'choppy water' InterFinancial identified as key influences on the business environment and deal making in the medium term were:

- **Balancing the Budget** – The government is going to start a process of balancing the budget in May. This means either reduced expenditure or increased taxes and these changes will impact the business environment;
- **Banks back to pre-GFC** – Banking has become very competitive in relation to the terms and conditions (covenants) of the debt and the interest rate. However the basic interest cover and leverage ratios are still being applied;

- **Limited mid-market capital** – Private equity funds offering \$20 million equity cheques or less is very limited. InterFinancial has seen the emergence of family offices and organised high net worth investors targeting the less than \$20 million equity cheque range;
- **Deal making** – Limited capital and uncertainty means that deals structures have changed. Risk sharing in transactions has increased with as much as 90 percent of transactions now having some form of earn-out;
- **The Asian Century** – A large number of global business are positioning for the high levels of middle class growth expected in Asia. Rightly or wrongly Australia is seen as a first step into Asian by many overseas companies. What this means is that companies that may have ignored the Australian market as being too small are now entering the market and as a result changing sector dynamics;
- **Mining industry cost restructure** – Sustainability and competitiveness in mining is all about where a business sits on the cost of production curve. Global capital allocation by the large miners means the quality of the resource in the ground, productivity and infrastructure needs to be the best in the world for Australia to be low on the cost curve and, as a result, attract global capital.

CONCLUSIONS

Ms Doyle said much of the advice InterFinancial was offering to clients reinforced their natural instincts, urged creative solutions and stressed that tough decisions should not be avoided.

“Trust your instincts,” she said. “In our experience business owners have good instincts about the market and their business. While there is uncertainty our view is that it is important to make the decisions that give direction through the choppy water.

“Look for creative solutions. Well-worn ways of doing business and transactions are changing and are likely to continue to change at a greater rate. As we are seeing in deal making, understanding the issues on both sides of the table and then bridging these with creative solutions such as earn-outs is a key to completing transactions.

“Don’t avoid the tough decisions,” Ms Doyle said. “It may be that the right decision is to sell your business now, even though the market price is below your previous price expectations.

“It isn’t uncommon where we take a business to market and the owner doesn’t sell due to the offer prices not being enough, for the business to be worth less or sell for less in the medium term.

“You need to make a realistic assessment of the sector dynamics and watch out for the 400lb gorillas.”

InterFinancial, which describes itself as a ‘creative corporate finance advisory firm, is also an Industry Expert member of Queensland Leaders, the organisation developing the state’s next generation of leading businesses.

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