

7 Takeaways from IANA's 2020 M&A Recap + 2021 Predictions

Tenney Group recently provided an overview to the Intermodal Association of North America of what happened in M&A in transportation and logistics in 2020 and what to expect in 2021. Below are 7 takeaways from the presentation.

1. Supply shortage of available companies to purchase affected valuations and leverage for sellers.

COVID-19 disrupted exit strategies across the country. Many owners of trucking companies that had scheduled to begin their exit from the trucking industry placed everything on pause in March 2020. This created a supply shortage of available companies to purchase. The competition for the remaining available companies to purchase became quite fierce in Q4. Consequently, several business owners received a valuation bump of approximately .25x -.75x EBITDA.

2. Deal structures account for new risks yet contain fair-mindedness.

Ordinarily, a performance dip in a seller's company generates an unforgiving response from buyers. That is not what happened in 2020. Because almost everyone in the trucking space was affected by COVID-19, both buyers and sellers approached the deal table with an unusual amount of fair-mindedness. As opposed to offering a long earnout period (3-4 years) that shifted all the risks to the seller, many buyers recognized the non-recurring, universal aspect of the moment and adjusted earnout clauses appropriately (6-12 months in some cases). Moving beyond 2020, this issue will evolve as more risks enter the market and broader economy.

3. More hurdles, attorneys, and risks to consider when addressing the purchase agreement of a sale.

When the market presents new risks around a transfer of business ownership, those risks must be properly accounted for within the purchase agreement. That was a challenge in 2020. Heidi Hornung-Scherr, Partner at Scudder Law, explained it this way. "2020, COVID-19, and the related uncertain economic environment (including with respect to freight) resulted in increased volatility in successfully negotiating, documenting, and closing M&A transactions. While it became more difficult to forecast timelines and likelihoods of success on the front-end, committed principals were and still are considering, negotiating, and closing M&A transactions. Sellers, buyers, their advisors and attorneys are building in additional contractual provisions to address COVID-19 and any CARES Act contingencies, increasing the amount of time it may take to obtain third party consents, and devising creative solutions to accomplish more due diligence through remote processes."

4. Diversification becomes driver for growth/acquisition strategy.

One of the most interesting trends in 2020 was the number of experienced acquirers in the trucking space that approached our firm with new strategic goals. COVID-19 seemed to reward one vertical within trucking while arbitrarily punishing another. This humbled many trucking business owners and heightened their sensitivity to having all of their eggs in one basket. Dozens of buyers updated their acquisition profiles within our system and cited "diversification" as a top strategic priority.

5. New administration signals tax changes that may profoundly affect business value/sale proceeds.

The new administration is proposing to treat any gain over \$1M as *ordinary income*. Currently, the long-term capital gains tax rate for gains over \$1M is 20% plus a 3.8% surcharge (total of 23.8%) plus any state tax. If Congress votes Biden's plan into law, the **federal tax rate on gains over \$1M will be over 43%** (39.6% plus 3.8%). That increase equates to an **additional \$1,960,000 in taxes for every \$10M of sale price above \$1M**. That is a remarkable amount of personal wealth moving from the hands of business owners to the hands of our government. For owners that have been considering an acquisition, merger, or business sale over the next 1-3 years, you need to be watching Washington and the developments around this proposed plan closely. It is also important to consider how this proposed plan could affect the way buyers, particularly private equity groups, value your business and approach acquisitions. If the available after-tax return on investment of purchasing your business is reduced (due to the proposed tax plan) then you should expect the valuation of your business to adjust accordingly. Investors are not going to pay the same money for a lower return on capital.

6. Disruption to supply of companies available to purchase will influence surge of transaction activity in 2021.

Deals that should have closed in 2020 pushed into 2021 due to additional steps required to get a deal done. Our recent sale of NRX Logistics is a good example. The deal was under contract and weeks away from closing in August. Out of nowhere, the buyer's bank placed a blanket moratorium on all acquisition financing (because of the risks and uncertainty around COVID-19). We helped our client pivot to a new buyer (Cardinal Logistics) and closed the deal the second week of January. In 2021, the public will see a surge of deal announcements. The activity represents 12-15 months of normal activity squeezed into 6-9 months' time. As the supply of available trucking companies to purchase normalizes, so will the leverage at the negotiating table.

7. First time acquirers will make their mark 2021.

The rising cost of insurance and other expenses is forcing many companies to expand their traditional growth playbook. Fraley & Schilling, an innovative industry leader for decades, made their first acquisition in 2020 by purchasing our client, KBT Enterprises. This is important for a few reasons. A) Many companies will build transformative business value and personal wealth as they integrate acquisitions into their broader growth strategies. You need scale to solve big problems in a low margin industry. Out of necessity, a new generation of leaders in trucking will rise up and do great things. B) Founders with small to mid-sized trucking firms looking to exit in 2021 will benefit from an expanded pool of buyers. The environment in 2021 will create more options to exit than what was available 3-5 years ago.

Bonus: Predictions for 2021.

- We expect to see a 20% increase in total transportation and logistics transportation reported deals. *Capital IQ reported 89 total deals in 2020 (59 trucking and 30 logistics).
- Trucking companies with \$50M+ revenue will receive a 10% valuation premium. Why? As many experienced acquirers use acquisitions to spread risks across different industry verticals, they will have very little tolerance for making mistakes. Buyers will pay a premium for established companies with proven leadership that can take the buyer to the next level.
- Small trucking firms will see valuations hold steady (assuming they can effectively offset the rising cost of insurance and other expenses).

Spencer Tenney is President and CEO of Tenney Group, a merger and acquisition advisory firm that has dedicated to transportation and logistics since 1973. Tenney Group has closed three trucking deals in the past 60 days and currently serves on the ATA's M&A Task Force. For more information, visit www.thetenneygroup.com or email dlooney@thetenneygroup.com.