We share steps you can use when preparing for a potential sale in 2023. (UBS)

Despite recession fears, a private sale still suits “strong businesses”

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Is the US mergers and acquisition (M&A) market unfriendly right now? Not if your business is robust, prepared, and has a solid track record of growth.

As business owners take a breather at year end and prepare for 2023, trouble looms in the form of a potential recession.

Case in point: The Conference Board pegs the odds of recession at 96% next year, with the last quarter of 2022 and the first quarter of 2023 experiencing negative economic growth.

“While recession probability hovered near zero after the initial phase of the global pandemic from September 2020 to March 2022, it rose to over 30 percent in April and reached 50 percent in May,” said Eric Lundh, principal economist at The Conference Board. “This means the US economy is likely to enter a recession within a year from that point onward. The probability has kept rising since then.”

Don’t count out middle market M&A just yet

At first blush, you’d expect a withering economic climate to dilute business activity, especially in the US mergers & acquisitions market, which historically declines during recessionary periods as companies snap their checkbooks shut.

Yet 2023 may be different, with several bellwether indicators issuing a flashing yellow, if not a steady green light for the M&A sector.

- While the 2022 deal volume is down from the record year of 2021, M&A activity this year is in line with the robust volumes from 2018 and 2019.

- There is still an abundance of capital in the system, as private equity firms are actively fundraising.
- When the current "dry powder" begins to "age out," well-capitalized investors may feel pressure to fund deals.
- On-hand cash shouldn't be a problem. According to Preqin, private equity firms currently hold a record $1.68 trillion in cash on-hand for deal-making.

While activity in the tech sector and with unicorns may be driving headlines, we believe that middle market businesses with strong fundamentals will still be appealing to potential buyers. And, while merger and acquisition activity may readjust on the downside, companies with good fundamentals will find ways to transact in the coming months.

Action steps to prepare for a potential sale in 2023
With competitive M&A activity still in play in 2023, senior executives can pivot to planning their company sales strategy.

When doing so, these five strategic preparation action steps should be at the top of the list.

1. Keep accurate and up-to-date records. Document what is being done, both tactically and strategically, to counter the pandemic-related shocks. For example, supply chain-wise, dealmakers are showing a preference to companies that are de-risking by reshoring or "friend-shoring" to politically friendly countries.

It's also a good idea to consult with your accounting team and third-party counsel to review any outstanding record keeping issues. For example, you'll need to make sure all material company contracts are signed and up-to-date and that all employee and outside contractors and consultant paperwork is documented and in compliance.

Also, consult with your accounting and corporate financial team, and any external business partners like a bank, broker or insurer, and ask if a formal audit or "quality of earnings" review is in order. Your team can advise you on the size and scope of any review or audit required.

2. Develop detailed marketing materials. It's vital that potential for-sale companies illustrate your company's business story.

That's especially the case when highlighting how your business responded and evolved throughout the global pandemic and how it has converted recent obstacles, such as supply chain, labor and inflation challenges, into the value creation opportunities that get companies noticed by private investors.

Be able to point to those success stories in marketing materials, on media and social media platforms, and on podcasts and video casts that either originate with the company or come from external content production sources.

3. Evaluate your business's key talent. Identify employees or partners who could be critical to a successful sale and look to ensure that these individuals remain with the company, despite the increased turnover occurring in the labor market.

Additionally, review and clarify your expectations for valued in-house talent for specific roles after a deal is complete, and when the time is right, be as transparent as possible with company staff to keep them apprised of key steps and issues related to the transition to new ownership.

4. Build your "A" team. Assemble a trusted internal team and an exit planning advisory team—including an investment banker, a CPA, an attorney and a financial advisor.

If necessary, bring in specialized outside advisors to help your business improve on areas that need attention during any potential lull in dealmaking activity.

5. Make post M&A personal planning a priority. Attending to personal planning with your "A-team" is highly encouraged in a sales deal, and preparation should start well beforehand. These two paired steps are highly advised.

- Create and develop strategies that, in partnership with your financial advisor and tax and legal advisors, would help improve the tax efficiency of any transaction and spotlight important legacy issues like family and philanthropy.
- Additionally, ask how to use gifting and trusts strategies to move potential appreciation out of your estate. Also check if you could take advantage of qualified small business stock or even charitable strategies to help mitigate your taxable impact and drive more impact for the people and causes you and your family care about.

Make no mistake, to be successful, many of these post-deal estate and tax strategies must be in place well before a potential "letter of intent" is signed with a potential buyer.

After all, with buyers likely to be more discerning with company valuations in a volatile economy, effective tax and wealth planning in advance should help create clarity on what business owners may need to meet their financial and legacy goals.

The takeaway on preparing for an M&A sale in 2023

Operationally, strategically and even emotionally, it's not easy to prepare for a financial exit. In many cases, when our financial advisors at UBS work with owners, it may take several months to be truly intentional and clear on the goals of business owners and how to build and execute on a plan.

That's particularly true in a declining economy that historically draws investors of all stripes to the sidelines.

Yet unique business and market circumstances may combine to upset the conventional wisdom and lead to more M&A activity in 2023—at least more than most executives think.

In such a scenario, companies should prepare for their business sales with an opportunistic viewpoint, just as private equity buyers will likely embrace their own version of opportunity as the new year dawns.

To be clear, those buyers will wade into the M&A market on the lookout for established businesses that prove to be financially stable through turbulent times.

That's exactly why the more business owners can do to shore up their operations and make their companies attractive for buyers, the better position they'll be in to exit on the upside with a company sale, despite any economic headwinds.

Read the UBS e-magazine The new paradigm, which brings together insights from leaders across the firm and beyond to tackle some of the core issues that are top of mind for business owners, and to offer solutions to not just overcome these challenges, but to thrive as the economy eventually turns the corner.

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