

# How Solomon Partners Views the Deal Landscape

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**Erin McLaughlin:** Now let's get going with our first session. Here to explore the forces shaping the current deal landscape and what's defining M&A strategies for the years to come is Marc Cooper, chairman and chief executive officer at Solomon Partners, and Steve Odland, president and chief executive officer of The Conference Board.

Please join me in welcoming them.

**Steve Odland:** You guys must have feared something here, cause everybody's sitting way back in the room. Anyway, well, welcome to our event this afternoon. Thank you for coming, and if you stay long enough, you'll beat the rain, and you won't have to go back out and get soaked.

Marc, thank you for joining us today. Tell us a little bit about Solomon Partners. What's sectors do you cover, and what's the range of what you do?

**Marc S. Cooper:** Well, just by background, Steve is an old friend and a client that maybe dates back 20 years in two of your [00:01:00] CEO-ships, AutoZone and then Office Depot.

And by the way, that might give you the bit of the heritage of the firm, which was in the retail consumer space, in fact, probably the leading investment bank within those worlds, and still is that today. We also have the distinction of being the oldest independent investment bank still in existence, started by Peter Solomon. In fact, the original name was Peter J. Solomon Company, which we've evolved. That was in 1989, so we've been in business for 37 years.

In fact, the other day was my 27th anniversary. Started when I was 12. The business is generally strategic advisory, M&A, along with some other services that are important to our clients. It has evolved in terms of our coverage expertise, from the original focus in the retail side, and 10 years ago, when I became CEO, we expanded. At the time, we were 30 bankers, primarily focused on consumer [00:02:00] retail, primarily M&A, with some capital advisory capability.

We're now approaching 220 bankers across 13 sectors. Retail, while still extraordinarily important, is probably 10% of our business. Think our biggest platform now is healthcare, broadly defined, FIG, financial institutions, among other areas. And still though, under the same principles that Peter started the firm and what differentiated us through these 37 years, which is deep industry expertise.

We always lead with knowing our sectors and being players in our sectors, cause really knowing that sector really differentiates the advice I think we can give to our clients and our partners. Number two, being great bankers. You can't just be a wonk, you have to be a doer. And we're doing what are, in many cases, the most important strategic transactions on behalf of our clients, and we have to know how to get them done.

And the last piece, which I think will truly differentiate us, particularly as we [00:03:00] go forward in this new AI world, is we're trusted advisors. We're people who care. It's not just a tagline, but it is an embedded cultural imperative that you have to do the right thing. It also makes managing the firm a little easier because you got nice people. And that's the firm.

**Steve Odland:** No, and it's true. You know, a lot of firms come out and say, "We do deals." I've never heard you say that, and that's not your approach. Your approach is, we offer advice. And I always felt that way as a client. But let's turn to the M&A environment. Last year was a big year in M&A. How does this year look?

**Marc S. Cooper:** Good. It started off strong. I think maybe 40%. But it's an interesting market, which I think is positive in many ways. It is driven by corporate acquirers, strategics. I think 70% of the volume, 80% of the volume is coming out of the strategic community, with about half of that being in-market [00:04:00] acquisitions, which are just companies growing within their own marketplace. A lot of that due to one, corporates doing well, profitability being good, stock prices at being all-time highs, and also a regulatory environment that is cooperative and allows us to get deals done.

I mean, we all saw what happened with Spirit Airlines, and we're not seeing that now. On the flip side, and that's the corporate world, the PE world last year was big-cap PE, billion-plus transactions, very active. Slowed down a bit this year.

Middle market is not so good. And the middle market PE is really still burdened by the excesses of post-COVID investing, high multiples—and pre-COVID—high multiples, and marks to market. That is, what they price the asset at in their portfolio [00:05:00] at being above where the market will clear these businesses in a sale process. So it's very

challenging. It's going to be a long and sticky battle getting them to pull through the system.

**Steve Odland:** So what kind of deals are getting done, and what kinds are not? You mentioned midmarket is slow, but just go by in sector speak.

**Marc S. Cooper:** So it's across a broad range of sectors when it comes to industrial, and it has to do with size, right? The statistics that could suggest, if you are larger, your margins will be higher. That's the savings and synergies. But people are being thoughtful about it. It's not expansion for expansion's sake. It's expansion when they believe there's a strategic imperative, and they believe those savings and synergies are very doable.

I think boardrooms are very bullish on the US, and this is the economy to invest in, and I think they're doubling down, and that's broadly defined. Yes, there are segments that are naturally going to be [00:06:00] more active. I mean, you look at pharma. They are serial acquirers because it's a buy versus build. They could either develop the new drug, or they could buy the new drug, and they're doing a whole host of both. And that's a very active market that won't stop.

On the PE side, it is relegated to generally, particularly, the middle market A assets. So it is a bit of a risk-off theory that middle market PE will pay historically high multiples for a business that they believe is bulletproof. They'd rather have lower upside with minimal downside, despite the fact that there are some great quote-unquote B assets that, if they were priced correctly, would generate a higher return.

But that's a bit of a risk-off environment. And because of the lack of return that they've given, bless you, given—their institutional investors refer to that as DPI—they are really [00:07:00] under the gun in making investments and being able to draw down capital from their investors.

In fact, fundraising is at a historic low, and it has skewed dramatically to the mega-cap funds.

**Steve Odland:** Yeah. We'll come back to PE in a minute. Every company that we talk to is having trouble with growth right now. AI, OK, but it's like everybody else, and they're struggling to drive the top line. How much of what you are seeing in the deal market is driven by just that absolute need for growth.

**Marc S. Cooper:** It's absolutely the case. And you hit it on the head. Now, organic growth is the holy grail, and that's the one where markets will give you the premium multiples. But if you could show a serial capability in making acquisitions and integrating those companies within yours, and truly integrating—cause there are plenty of roll-ups that you look 10 years forward and it's, you know, 10 disparate companies, that's not going to work. In fact, those have been some [00:08:00] of the failed transactions.

It's the ones where you truly bring them in, and markets value that, because they will give

you credit, because usually there's going to be multiple expansion, or I should say accretion. Because you're going to buy something, hopefully at a bit of a lower multiple, but even if you don't as to where you're trading, and you have the savings and synergies on an adjusted basis, you're going to have that accretion.

So it works. And it's not an easy environment for organic growth, but it's a very good environment for acquisitions to drive that growth.

**Steve Odland:** Yeah. And the value of an asset or value of a firm is the net present value of future cash flows, except when you start looking at multiples, and the multiples tend to correlate to top-line growth.

**Marc S. Cooper:** And the market, as I said, if you're a good acquirer, and they believe that you're integrating, they're going to give you that. And in fact, you're seeing companies that have just been built to do that. QXO, [00:09:00] am I saying that right, is all about rolling up building products companies, and he's just made two big acquisitions over the past couple of months, and he trades beautifully. He's buying, he's buying a bit low, and he's getting the premium multiple. And by the way, this has been a theme over the past 10 years in private equity within sectors like doctor practices, lawn care, environmental services, HVAC, all these sort of basic businesses that are inherently slow growers.

But if you roll them up, theoretically put professional management on top, and CRM systems to drive productivity, that you're going to build a better mousetrap. And in many cases, they have. In a bunch of cases, they haven't.

**Steve Odland:** that most of the ERs in hospitals in this country now are owned by PE, which is just a frightening thought. You expect to see a doctor when you [00:10:00] arrive, but you see a banker instead. It's, ""Hello." "Let's see your insurance first,"

Another way to drive the top line not only is to acquire faster growers than your average, but also to divest your slower growers, right? And so you're seeing divestitures, as well.

**Marc S. Cooper:** Absolutely. And actually, PE loves carve-outs, because it's an opportunity to actually work it, create value, show their stuff. And it's absolutely the case where if you're going to look to—you know, everything's about growth, right? So what's the multiple of a public company? It's the inverse of the growth rate. You could either do it by addition, or you could do it by subtraction. And they're doing it.

And they're also doing it to maintain a strategic rationale for the business. Conglomerates are out, and focus is in, and it's been that way for a long time. And even if it is even two degrees of separation in terms of the focus, that could be enough. Also, you see it in pharma, where Merck spun out some of their [00:11:00] legacy businesses and focusing on sort of the growth assets.

It makes total sense because, to Steve's point, it is ultimately the present value of the cash flows over time. And if you've got a bunch of cash flows that are growing slowly,

that's going to lower your multiple.

**Steve Odland:** Yeah, and you're seeing splits and spin-offs. Kellogg's just split up, and then it was the pieces were sold. You just see it over and over again. Kraft went through and was going to split, and then Berkshire said, "Please don't," and then didn't.

So I mean, you're seeing a lot of this portfolio shaping or sculpting, however you want to say it. But it comes back to the whole notion of driving incremental growth.

**Marc S. Cooper:** Yeah. And a lot of its rationale because what we always hear is, you spend 80% of your time on a management basis on 20% of your assets, which aren't growing as quickly. And what if you spent 80% on the stuff that's going great? How much better would you do?

Having said that, you can't fall into the [00:12:00] trap of, "Oh, they're doing it, and so we need to do it," despite the fact that maybe you don't need to do it. And so, it's not about perpetual movement, it's about doing something that really makes sense. And you're going to see a lot of it now.

It's a good market. It's a good time. 24-hour news will make you believe that interest rates are at historic highs. I mean, I had a mortgage back in, I hate to date myself, but a mortgage back 25 years ago. It was 10%, and I thought I was the smartest financier around. So despite the fact that we have an interest rate environment that's a bit high, inflation maybe 3%, I mean, these aren't bad numbers. In fact, they're quite accommodating to do business.

Now, we look back three years ago, and it was zero, or five years ago, that frankly is a disaster, right? Because all that means is you're going to have inflation, and you're going [00:13:00] to have excess. So this allows you to really price risk. This allows you to invest. This allows people to be thoughtful. It puts a little, you know, guardrails around folks. So I think we're in a good spot.

We have a—like the administration, don't like the administration, but it's pro-business, except for the one here. If you went—

**Steve Odland:** Which one would that be?

**Marc S. Cooper:** Yeah, I wouldn't know. If you went and read Ken Griffin's interview today. But it's pro-business. It is accommodating, but not crazy, in DOJ. The last one was, that's another story. And that was difficult. So it's good, and I think, despite all the geopolitical issues—and what's great is positivity, you see markets going up, you see people investing, you see deals happening, despite the fact that you might hear on 24-hour news that the world's coming to an end. Well, hopefully it's not.

But there's one recognition, and the one recognition is this is the [00:14:00] place to be. It's not China. It's certainly not Europe. It is the US. This is the place to be, and I think

CEOs and boards know that, and they're doubling down.

**Steve Odland:** You talked about private equity. Let's go back, cause private equity funds, as well as venture capital funds, they used to raise their fund, they used to have a roughly a seven-year life. And then, if they didn't flip individual assets, they flipped the whole fund, and they traded it between. But that's not happening right now, in every case, certainly in VC . It just seems to have frozen. That's counterintuitive to what you described in the market.

**Marc S. Cooper:** Well, not in the middle market. So, VC and private equity sort of diverge. VC is a function of the strength of underlying sectors that they're investing in. And yeah, if you're AI, you're doing great. But if you're software, you know, you're not doing so great. And also the health of the IPO market, cause generally, a lot of their exits comes from the [00:15:00] form of IPOs.

Now, biopharma, a little different. That's going to be sale transactions by the big pharma. The big issue is up through, since 2010 maybe to 2020 or so, I think the average premium to net asset value, so where they booked the asset, was like 24%. Over the last bunch of years, it's been negative.

And so what does that mean? That means they paid too much for assets. They're keeping them marked at sort of historical values, not necessarily where the market is today. And that the reason is simple. If they sell it at a lower mark, it calls into question all their other marks. And how do PE raise capital? Because they have returns, and all of a sudden they're not in that business, and the business is buying, selling, raising capital, buying, selling, raising [00:16:00] capital.

And you have another phenomenon. It was a boom in middle market PE, call it, again, 2010 on. 2018-'19 vintage were the biggest funds that some of these PE guys, the middle market guys raised. They went from \$300 million to a billion to \$2 billion and then \$5 billion. And guess when \$5 billion hit? 2018. Guess how those funds are doing? Not so good.

Now, it doesn't make them bad investors. It just makes them unlucky, with bad timing. And so everyone has good vintage funds, bad vintage funds, cause it happens. And that's a bad vintage fund. But when the biggest amount of money you've raised is in the bad vintage fund, you have an issue.

Now, is that the problem for Apollo, KKR, Carlyle? No, cause they raised \$15 billion, \$15 billion, [00:17:00] and so, OK, bad vintage fund, no big deal, next fund. And everyone looks at the totality of their performance and says, it's fine. These are issues, and it's going to take time for those to work through, particularly in the middle market.

And there are going to be many PE firms who don't raise new capital, which is also a problem because what we refer to as these zombie funds. Somebody said to me, "There's a trillion dollars of invested capital in quote-unquote zombie funds." If you're a zombie

fund, throw out the workbook of the cycle of sales, because now they're not running it for IRR. They're not running it for return. They're running it for cash. And so they're going to keep it for as long as they want to keep it for because they know, at the end of the day, they're not raising a new fund, so they might just maximize value of the cash.

**Steve Odland:** Marc, we're out of time. I just want to thank you for starting the conversation today. We're going to have a lot more to come, but thank you for [00:18:00] joining us today, as always.

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