M&A

15TH ANNUAL MERGERS & ACQUISITIONS OUTLOOK SURVEY

Dykema

15th Annual
Mergers & Acquisitions
Outlook Survey

Dykema

In our 15th annual survey, we polled senior executives and advisers across the nation—CEOs, CFOs, owners, managing directors and other professionals involved in M&A activity within their respective firms—to measure their experiences and outlook on mergers and acquisitions in the coming year.

We would like to thank all survey respondents for their time and insights.

M&A Optimism Drops After High-Flying 2018

Thirty-three percent of respondents to Dykema's 15th annual M&A Outlook Survey are bullish about deal-making in the U.S. over the next 12 months. That's down from 65 percent in 2018, which reflected jubilation in the wake of the Tax Cuts and Jobs Act passed in late 2017.

A year later, notes of pessimism from some respondents—strong notes, at times—are clear, but where M&A activity and the broader economy are headed depends on whom you ask.

Thirty-two percent of respondents are pessimistic about U.S. M&A activity in the next 12 months, likely due in part to softening overall deal volume. That negative sentiment is significantly higher than in any of the past four surveys, in which a bearish outlook never exceeded 20 percent. Dealmakers are most worried about the impact of trade tensions with China and U.S. political uncertainty.

Still, 2019's overall M&A volume has been relatively strong by historical standards, and a plurality (36 percent) of survey respondents said the U.S. M&A market will see no significant change in the next 12 months. But with respondents connecting the fate of M&A activity and the broader economy, talk of an economic downturn has potential negative ramifications.

"We are on a recession watch on a daily basis," said Cyrus Nikou, Founder and Managing Partner of private investment firm Atar Capital. "We see deals that from a volume perspective are still there, but fewer transactions are getting executed."

Survey respondents said general U.S. economic conditions were the greatest driver of U.S. M&A activity this year, ahead of availability of capital, which was the top choice in the previous six surveys. Another factor related to the general economy, financial market performance, also ticked up as a driver in the eyes of respondents.

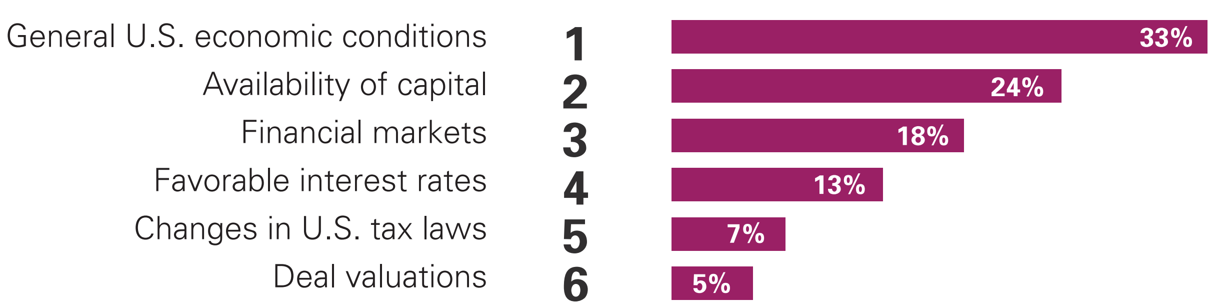
The change in M&A drivers suggests that some companies are making deals to cope with slow organic growth. It also suggests that other dealmakers are hurrying to make deals before a downturn, anticipated or otherwise, and expect downgraded valuations in the coming year. Forty-one percent of respondents agree that M&A valuations will decline in the next 12 months, and of them, a large majority said valuations will start dropping within nine months. Only 16 percent disagree with the idea that valuations are set to fall.

But in a major signal of uncertainty, a plurality of 43 percent of respondents neither agree nor disagree with the idea that valuations would fall. And that, as much as any data point in this year's survey, might sum up the wait-and-see nature of our current moment.

12-Month Outlook: M&A Optimism Drops, Pessimism Rises

	2015	2016	2017	2018	2019
Positive	37%	33%	39%	65%	33%
Neutral	43%	47%	41%	20%	36%
Negative	20%	20%	20%	15%	32%

Changing Drivers of M&A Activity



For the first time in six years, the availability of capital was not the factor selected most for fueling M&A activity. General U.S. economic conditions moved into the top spot, and financial markets increased by 7 percentage points. Both changes could be signs dealmakers have shifted their thinking given recession speculation.

Concerns About the Broader Economy

What respondents think about the broader economy closely resembles what they think about the future of M&A. In each instance, the pool of respondents is split roughly into thirds among bullish, bearish and neutral. As with the M&A outlook survey results in the U.S., there was a big drop in optimism compared with 2018, with negative sentiment about the broader economy at 28 percent, its lowest point since 2012. Still, in spite of recent recession talk, 72 percent of respondents remain bullish or neutral on the economy.

"The U.S. economy continues to be strong," said Nick Mehall, Chief Financial Officer of Republic National Distributing Company. "But concerns around the European economy and the influence it will have on the U.S. economy are definitely why some of the recessionary bells are being rung. Coupled with uncertainty surrounding trade negotiations and the fact that we haven't had a long-run growth like this historically, we are all expecting some level of pullback in economic growth."

But "when" and "how bad" are the open questions. Those respondents who were more optimistic going into 2020 point to positives such as historically low unemployment, steady economic growth, solid corporate earnings and the fact that economies usually perform well in election years. For many respondents, even this summer's sighting of an inverted yield curve wasn't as concerning when other signs are not present, like a serious drop in consumer confidence. A plurality of 31 percent of respondents cited consumer confidence and spending among the two most relevant economic indicators predicting a recession. Interestingly, consumer confidence did fall sharply in September, though it's relatively high by historical standards.

Still, recession talk appears to be weighing on many survey respondents. Approximately half said a recession is at least somewhat likely in the next 12 months. Twenty-four percent were neutral, and 27 percent said it was unlikely or somewhat unlikely. There was no clear consensus among respondents about how bad a recession could be, but one predicted a "shallow, short-lived recession with a significant slowdown in M&A and business expansion." Another said the bevy of recent recession predictions means that a downturn "won't be the shock the 2008 recession felt like."

The belief that any downturn will likely be mild tracks with the thoughts of dealmakers we spoke with, including Sidney Dillard, head of the Corporate Investment Banking Division at Loop Capital. "I feel like it would be more like a softer-landing recession that doesn't shake everything up," she said. "The element that is a bit new is that the political environment is totally unpredictable right now."

Economic Pessimism Returns

What is your outlook for the U.S. economy generally over the next 12 months?

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Positive	51%	37%	29%	8%	35%	21%	18%	25%	50%	62%	48%	28%	60%	64%	**38%**
Neutral	23%	47%	50%	28%	49%	59%	50%	43%	41%	27%	37%	54%	30%	27%	**34%**
Negative	25%	17%	21%	64%	16%	20%	32%	32%	8%	11%	15%	18%	11%	8%	**28%**

> "Coupled with uncertainty surrounding trade negotiations and the fact that we haven't had a long-run growth like this historically, we are all expecting some level of pullback in economic growth.
>
> — Nick Mehall, Chief Financial Officer of Republic National Distributing Company

Political Uncertainty, China Top of Mind

We asked respondents about the greatest threats to M&A activity over the next 12 months—and the top two choices are clearly related. Trade tensions with China topped the list (43 percent), and U.S. political uncertainty was second (35 percent).

Politics are clearly on the minds of many dealmakers, and we asked them about the impact that next year's presidential election might have on M&A activity. A plurality of respondents (38 percent) said that the elections would have a negative impact on U.S. M&A.

Reflecting a polarized environment, responses about politics varied. One respondent said President Trump has provided companies ways to strengthen their portfolios, so they're "looking to merge, etc., and will want to do so now while he's still in office." But another said, "Trump's re-election could scare the market."

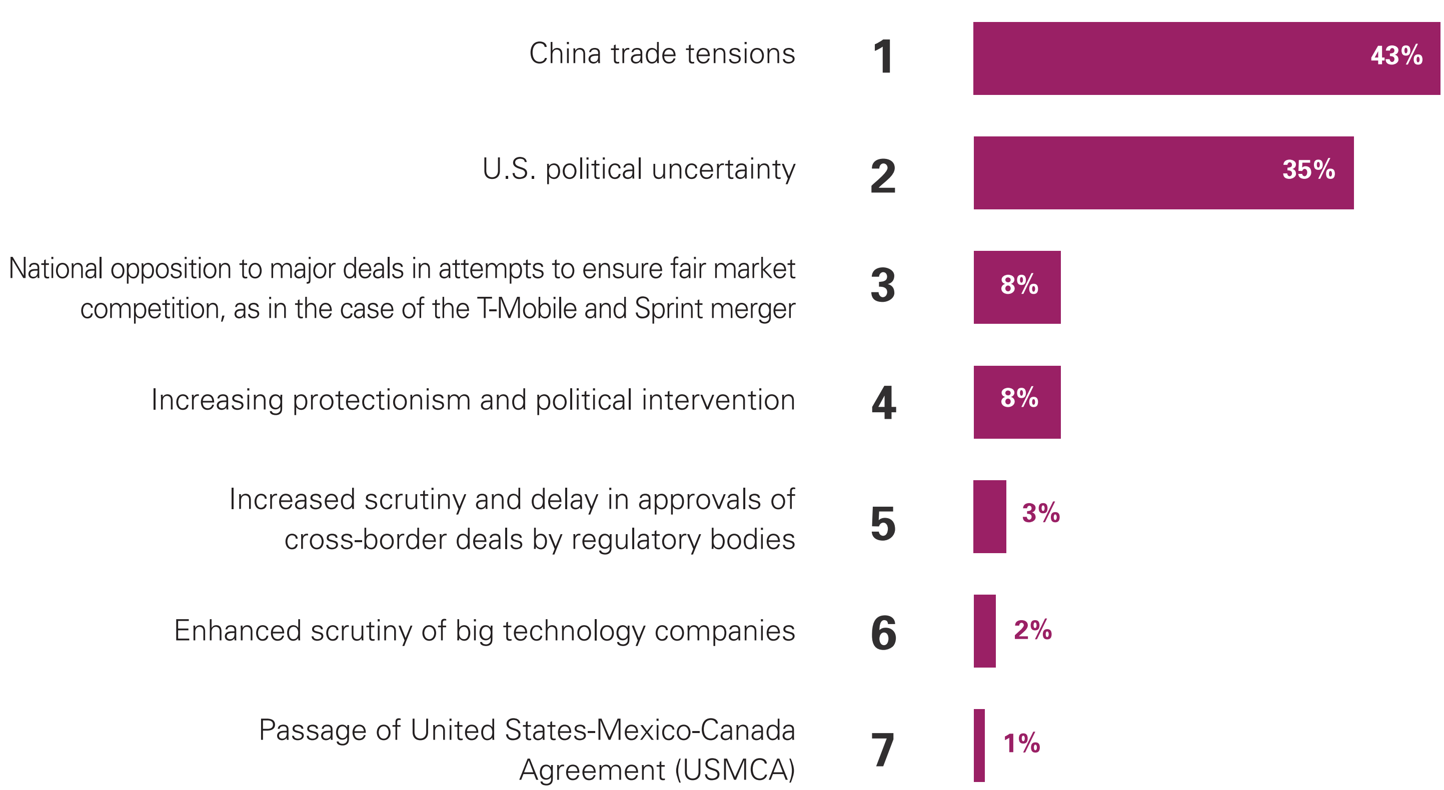
However, there was one overriding theme from respondents—uncertainty surrounding who will be the next president is not good for M&A. As one respondent noted, "In 2016, the M&A market seemed to pause while the whole election process was ongoing—that could happen in 2020."The second major theme was concern that a Trump loss would undo 2017's Tax Cuts and Jobs Act. Unlike many of the other political issues we asked about, which tended to dampen enthusiasm about M&A activity, respondents said corporate tax reform was still spurring deals.

Conversely, more respondents in 2019 said Brexit and recent reforms regarding foreign investment in the U.S. have delayed deals than in 2018. Primary among the M&A-supporting issues that respondents would like the president and Congress to focus on are free trade, immigration, tax reform, the minimum wage, deficit spending and deregulation.

"As we've seen in many industries, any time you layer on additional regulations you make it tougher for businesses to compete—and it ultimately impacts the M&A market," said Brian Demkowicz, Managing Partner and Co-Founder of Huron Capital.

Tensions With China, U.S. Political Uncertainty Greatest Challenges to M&A

Beyond the U.S. economy, which of the following poses the single greatest challenge to M&A over the next 12 months?



The China Question

Respondents said trade tensions with China are the single greatest challenge to M&A activity in the coming months. But the complexity of the issue shone through in another finding: China also was the country respondents said would have the most outbound U.S. M&A activity in the next 12 months. China didn't even make the top five in 2018.

Why the change in projected M&A activity to China? Tensions between the U.S. and China are arguably higher than they were a year ago. But U.S. companies might be trying to establish a foothold in China so they can sell products there, figuring it will only get harder to ship goods to the world's second-largest economy.

At the time of the survey, respondents may have been hopeful that China would continue with its promise to ease restrictions on foreign companies. Based upon recent events, we will have to wait to see if that hope is realized.

Anticipated M&A Activity Outbound From U.S.

2018		2019
Europe	1	China
Central/South America	2	Europe
Mexico	3	Canada
Canada	4	Japan

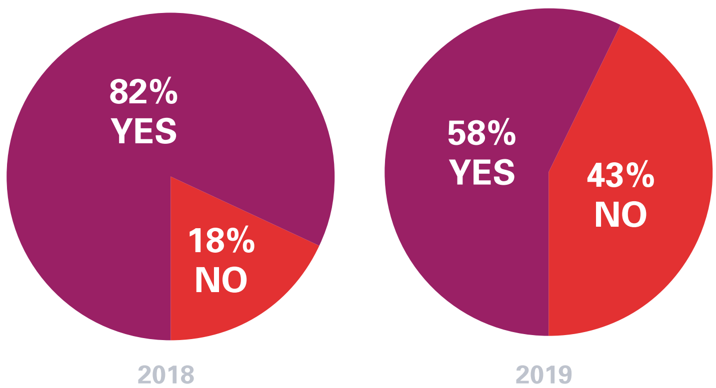
Respondents to this year's survey expect U.S. dealmakers to focus on China for M&A activity, despite ongoing trade tensions.

The Shape of Deals to Come

Regarding their own companies, respondents said they are less likely to be involved in acquisitions, joint ventures and dispositions than they were a year ago—consistent with the drops seen throughout the survey when compared with 2018 responses. But the news isn't all bleak. Sentiment about M&A activity involving privately owned businesses is fairly strong, with 58 percent expecting it to increase in the next year—though that's down from a heady 82 percent in 2018.

Declining Optimism for M&A Involving Privately Owned Companies

Do you expect there to be an increase in M&A activity involving privately owned businesses in the next 12 months?



After reaching levels last year not seen since 2014, optimism about M&A involving privately owned businesses fell in 2019. The overall sentiment was still positive, though more respondents expect activity to be driven by concerns about the window closing.

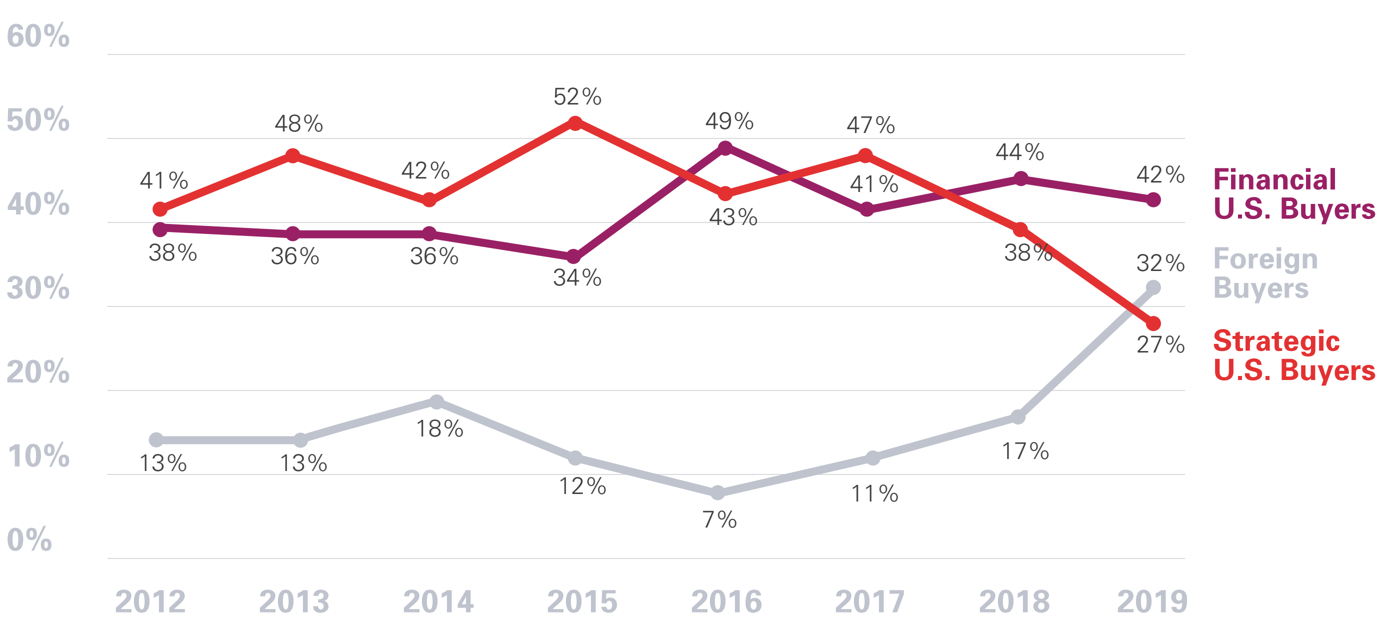
Financial U.S. buyers, as they were in 2018, are still expected to be the biggest influencers in U.S. deal valuations. That's a sign that reflects the "dry powder" sentiment among many experts. "Deals must get done—private equity firms have to put capital to work," Loop Capital's Dillard said. "Private equity activity accounts for about 40 percent of transactions in the market, and I do not think that will change."

"With capital available—and the U.S. Federal Reserve keeping interest rates low—an economic downturn could actually spur some deals," experts said. "We've learned over time that there are prime investment opportunities in good times and bad," said Huron Capital's Demkowicz. "Regardless of the economic climate, we have been able to consistently find good companies where we can invest at a reasonable price even if others may be pulling back entirely, not wanting to jump in. It takes a certain amount of courage to do that."

But compared with 2018 sentiments, respondents believe foreign buyers will have a greater influence on valuations than strategic U.S. buyers, perhaps because the U.S., despite recession talk, is still a relatively safe bet compared with other countries where economies have already slowed.

Financial Buyers to Lead Way in Valuations

Which of the following types of buyers has most influenced U.S. deal valuation over the past 12 months?



Industries to Watch

The five industries respondents said would be most active in the next 12 months largely stayed the same from 2018, though health care moved up two spots. Automotive was first for the second year in a row—likely the result of how technology continues to reshape a quickly evolving transportation industry. Energy, which was in the second spot last year, moved to third. Despite a decline in M&A activity in that sector in the past year and low oil prices, respondents see promise in energy because of midmarket activity.

Health care is a sector that has had healthy M&A activity for years, and investments in that area might be less affected by a recession. Nikou of Atar Capital listed the sector as "defensible," along with the recycling and waste industry.

Nikou's sentiment about health care was shared by Loop Capital's Dillard. "What we are increasingly likely to see is more opportunities in health care, because it has better margins and there is more room for error, versus sectors where it is easier for things to go awry when the economy changes," Dillard said. "Also, there will continue to be opportunities in technology. There is a higher trajectory for growth there."

In which of the following sectors do you expect to see the most M&A activity over the next 12 months?

2018		2019
Automotive	1	Automotive
Energy	2	Health care
Consumer products	3	Energy
Health care	4	Consumer products
Technology	5	Technology

Automotive topped the list for the second year, with health care moving up two spots in 2019.

"What we are increasingly likely to see is more opportunities in health care...

— Sidney Dillard, Head of the Corporate Investment Banking Division at Loop Capital

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Methodology

In September and October 2019, national law firm Dykema Gossett PLLC distributed its M&A Outlook Survey via email to a group of senior executives and advisers including CEOs, CFOs and other company officers and executives. The survey respondents represent a cross-section of M&A professionals and advisers in a diverse group of professions and more than a dozen sectors, including automotive, energy, food and beverage, health care, retail, technology, industrial/manufacturing and financial services. Respondents represent companies with annual revenues from less than $1 million to more than $1 billion. Due to rounding, percentages used in some results may not add up to 100 percent.