M&A

18th Annual
Mergers & Acquisitions Outlook Survey

Dykema

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Dykema's 18th Annual M&A Outlook Survey reflects tempered optimism by dealmakers in the coming year, despite historic inflation levels, increasing interest rates and recession fears, signaling a return to pre-pandemic deal activity levels, buyer-friendly deal terms and opportunities for acquirers with dry powder and strong balance sheets.

Hello.

In our 18th annual survey, we polled senior executives and professional advisors across the nation—CEOs, CFOs, business owners, managing directors, fund managers, investment advisors, and other professionals who engage in M&A-related activity at their respective firms—to measure their outlook on mergers and acquisitions in the next 12 months.

We hope and trust you will find the following report and its insights valuable as you navigate the M&A environment in the coming months.

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

Sincerely,
The Dykema Mergers & Acquisitions Annual Outlook Survey Team

Thomas S. Vaughn
Member
Detroit
313-568-6524
tvaughn@dykema.com

Jin-Kyu Koh
Member
Ann Arbor
734-214-7632
jkoh@dykema.com

Frank D. Ballantine
Member
Chicago
312-627-2509
fballantine@dykema.com

Jeffrey C. Gifford
Member
San Antonio
210-554-5560
jgifford@dykema.com

Economic Concerns, Rising Interest Rates to Temper Deal Activity

Amid historic inflation levels and a series of Federal Reserve rate hikes, the U.S. M&A market is expected to downshift from last year's high-water mark as the economy slows. Macro- and micro-economic conditions are not expected to substantially reduce M&A activity but instead to reallocate dealmaking across a select range of industries and buyers.

That's according to Dykema's 18th Annual M&A Outlook Survey, in which respondents tempered their optimism compared to 2021 but appeared to see opportunity amid the volatile economic landscape. Sixty-five percent of the executives and financial advisors we surveyed expected the U.S. M&A market to strengthen in the next 12 months—down 10 percentage points from 2021, but far from the large-scale decrease in dealmaking confidence one would anticipate in an economy widely viewed as being on the brink of a potential recession. Still, respondents expecting the M&A market to weaken in the next 12 months increased to 22% from 7% year over year, and expectations for deal volume to strengthen dropped across the board, from small and midmarket deals to megadeals.

These findings reflect a stormier outlook than that from last year's survey. But with some $81 billion in U.S. M&A activity through August, the broader M&A market has shown itself to be reasonably resilient in the face of strained lending markets, slow growth, and recession fears.

Dealmakers' wary optimism, perhaps bolstered by the above, may stem from three key factors. Firstly, in the long term, respondents may be resigned to the fact that a market cooldown is the bitter pill they will have to swallow as the Federal Reserve seeks to bring down inflation and avoid an economic quagmire. Secondly, with substantial dry powder sitting on the sidelines, dealmakers likely have the ability (and need) to do deals, even in the face of current economic conditions. Further, this dry powder will allow dealmakers to capitalize on lower valuations resulting from current economic conditions. Thirdly, economic conditions are expected to fuel distressed and turnaround deals, with 75% of dealmakers anticipating that economic conditions will boost those deals over the next 12 months.

Meanwhile, concerns about the state of the economy have multiplied. The share of respondents with a negative economic outlook increased threefold from 9% in 2021 to 27% in 2022. Over 70% of respondents expect a recession to occur in the U.S. in the coming year, and 7% said we are already in one. But despite the rise in economic pessimism, the impact of a recession on M&A activity was not viewed as formidable. In fact, more than half of respondents believe a recession could have a positive impact on deal volume, and only 10% think it would significantly decrease volume.

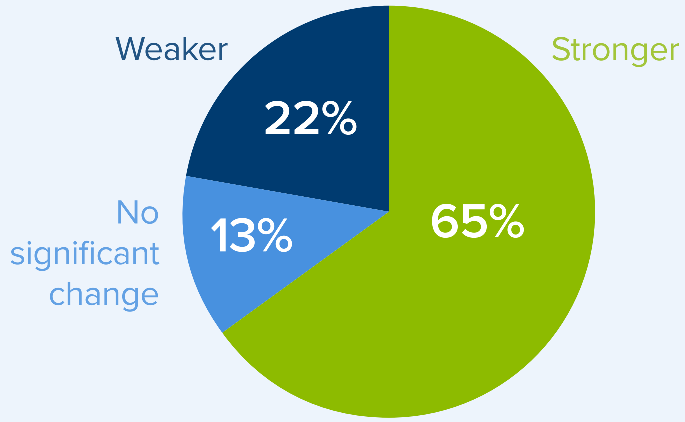
In addition, dealmakers are torn on the influence of this year's political landscape on M&A activity. A sizable majority of respondents view President Biden's 2021 infrastructure bill—which includes $7.5 billion to help build a nationwide charging network that will benefit the electric vehicle (EV) sector and $65 billion in clean energy investments—as most likely to have a positive impact on M&A, with changes in tariffs following close behind at 55%. But they are divided regarding broader political impacts. While the president's overall legislative agenda is seen as positive for M&A by 45% of dealmakers, more than one-third view his agenda as having a negative impact. That split is mirrored in our findings on the impact of a change in congressional control: 57% of respondents expect a Republican-controlled House and Senate to have a positive impact on the M&A market, but nearly half (48%) of respondents expect the continuation of a Democrat-controlled House and Senate to have a positive impact.

Reflecting further divergent outlooks within the M&A market, dealmakers named rising interest rates, economic conditions, and growing inflationary pressure as the top deterrents to M&A activity—while citing the financial markets, economic conditions, and rising interest rates as its biggest drivers. This suggests we may be entering a market of haves and have-nots, in which buyers with a large amount of liquidity—and consequently, no need to borrow at high interest rates—expect to take advantage of buying opportunities and close more deals in the coming year. In contrast, buyers who have routinely relied on banks to finance a large percentage of their acquisitions are anticipating greater roadblocks to funding their deals. No matter how you slice it, 44% of dealmakers agree that inflation is the top challenge to M&A activity, followed by geopolitical tensions and supply chain disruptions at 32% and 31%, respectively.

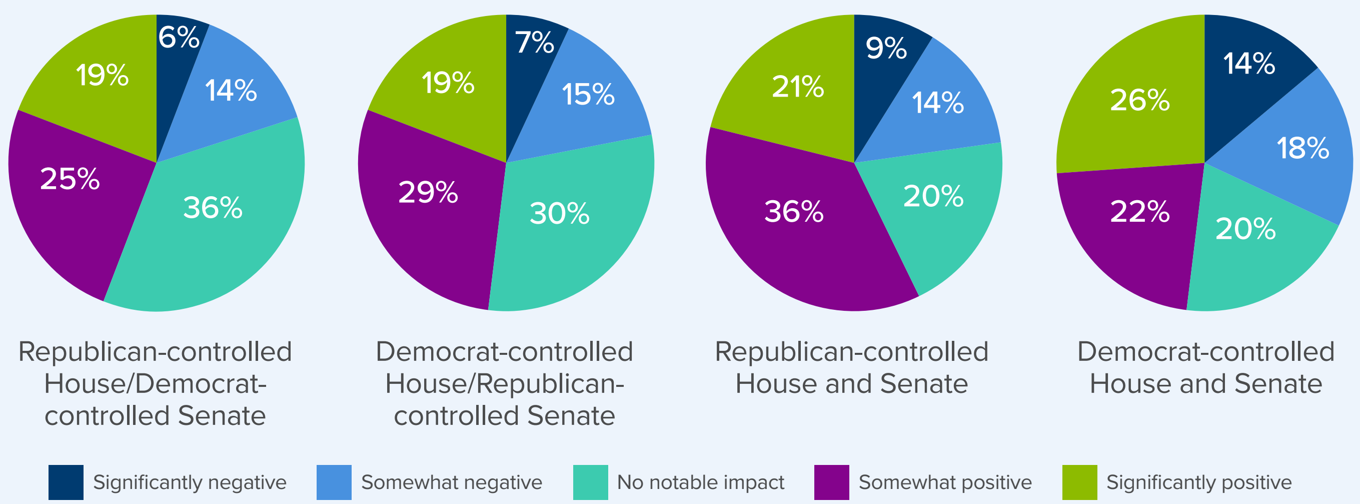
For now, it appears dealmakers remain hopeful, if vigilant, in the midst of economic turbulence. With the effects of COVID-19 subsiding and hoped-for easing of supply chain constraints, players with cash reserves still have opportunities in the coming year—even if that means shifting toward tighter due diligence, smaller add-on acquisitions, and cross-border outbound deals.

M&A Market Remains Buoyant in the Face of Economic Uncertainty and Rate Hikes

How will the U.S. M&A market for the next 12 months compare to the last 12 months?



What impact would a change in House and/or Senate control have on M&A activity?



How will current economic conditions impact the number of distressed or turnaround deals in the next 12 months?

4%	9%	12%	34%	41%
Significant decrease	Small decrease	No notable impact	Small increase	Significant increase

While recession fears, geopolitical upheaval, and Fed rate hikes have dogged dealmakers, 65% still believe the M&A market will strengthen over the coming year. Moreover, 75% of dealmakers anticipate a positive lift in distressed and turnaround deals. Respondents are torn on the effect of a new Congress's legislative agenda on M&A—an indication that the midterm elections may not be a significant headwind for dealmaking.

M&A Outlook Stays Cautiously Optimistic Despite Key Challenges

Despite a slight deceleration from last year's bullish sentiment, dealmakers have still found room for optimism in the coming year. Eighty-one percent of respondents, for instance, expect M&A activity involving privately owned businesses to increase over the next 12 months—but those expectations appear tempered in comparison to our 2021 survey, in which 90% of respondents anticipate the same. Moreover, 19% of respondents believe private M&A activity will decrease in the coming year—a slight gain of 9 percentage points from last year's survey.

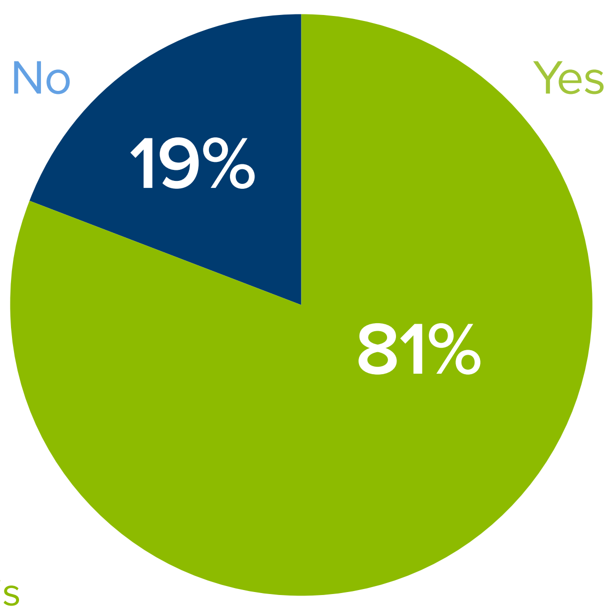
A majority of M&A dealmakers also expect their deal volume across several transaction types (sales, acquisitions, and joint ventures) to expand in the year ahead, albeit at a slower pace than last year. Since a bear market typically opens the door for opportunistic acquisitions, it's likely that dealmakers with access to credit and capital are starting to target companies not currently for sale, hoping they'll change their tune over the coming year.

In the same vein, 75% of dealmakers believe that economic conditions will increase the number of distressed and turnaround deals in the coming year. In a cooling M&A market, investors without ready access to capital or financing may be driven toward smaller add-on acquisitions, whereas well financed players will take advantage of more attractive valuations and may be drawn to roll-up strategies. Whatever the case, these approaches are likely to sustain deal volume to some degree and, in turn, bolster dealmakers' confidence in their ability to carry out transactions.

In fact, dealmakers have not expressed widespread concern about the impact of the nation's overall economic outlook on M&A. While 71% say a recession in the U.S. is at least somewhat likely in the next 12 months—and another 7% believe we are already in one—about half of respondents expect a recession will actually increase dealmaking, and 13% believe a downturn will have no notable impact on M&A deal activity. If dealmakers are speculating that the recession will be corrective—rather than indicative of the precipitous downturn the U.S. experienced in the 2007-2008 fiscal crisis—it tracks, then, that well-positioned acquirers will see the potential for buying opportunities in a downturn. Barclays Private Bank's Mid-Year Outlook anticipates no defaults on BBB bonds over the next six months, another sign that the market may simply be evening out from the excesses of COVID-19. Further, 54% of respondents still have a positive outlook for the U.S. economy over the next year, despite recession fears, suggesting they believe any recession will be short-lived. Aging baby boomers may finally be seeing that valuations are leveling off and decide it is time to consider an exit.

This year, increased corporate earnings are again viewed as a leading driver of private company M&A by 21% of respondents—though the share decreased from 34% in 2021—followed by rising interest rates and inflation concerns, both of which respondents also ranked as some of the biggest dampeners on deal activity. Inflation and rising interest rates may be perceived as double-edged swords for deal flow. While buyers may have to increase their level of due diligence and face decreased access to funding, they can also force sellers to accept lower purchase prices, seller note financing, and earnout structures to bridge differences between seller and buyer valuations, presenting buying opportunities for well-financed buyers. In addition, it may be that outlooks vary by industry—deals in healthcare, for instance, a sector bolstered by the turn to telehealth, may still prove lucrative in light of widespread labor shortages.

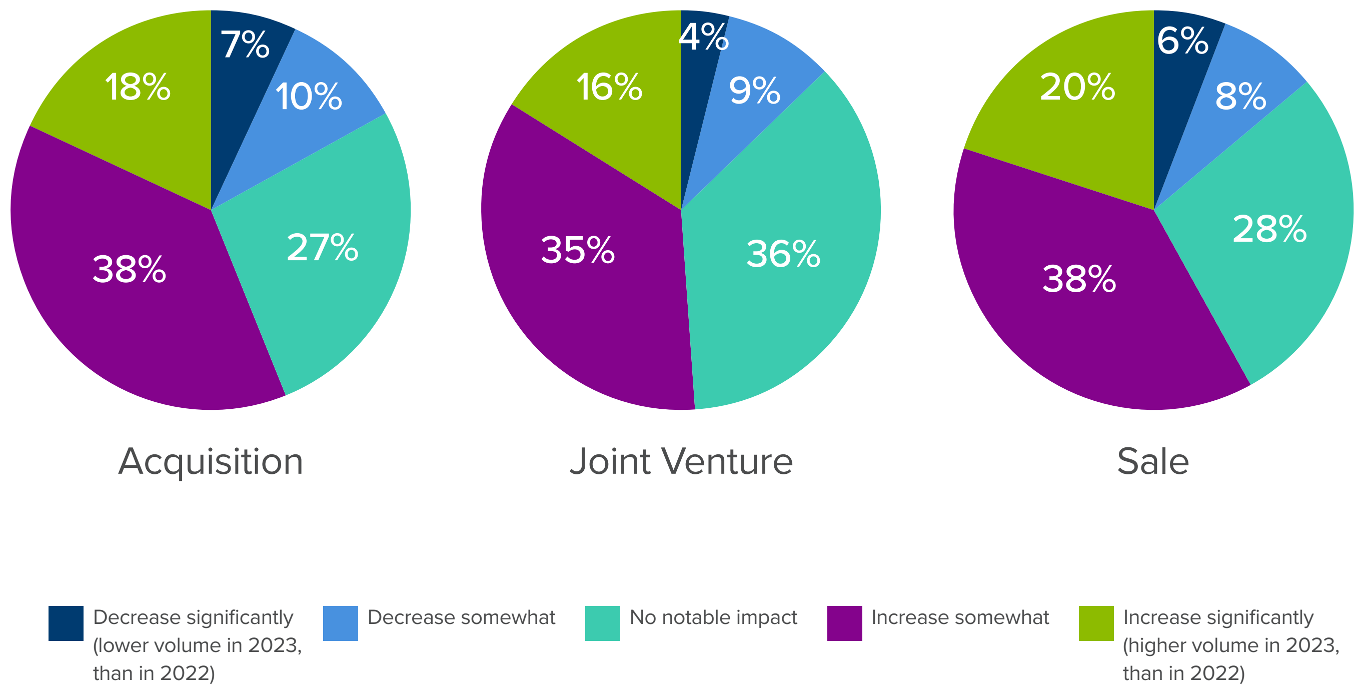
Do you expect there to be an increase in M&A activity involving privately owned businesses in the next 12 months?



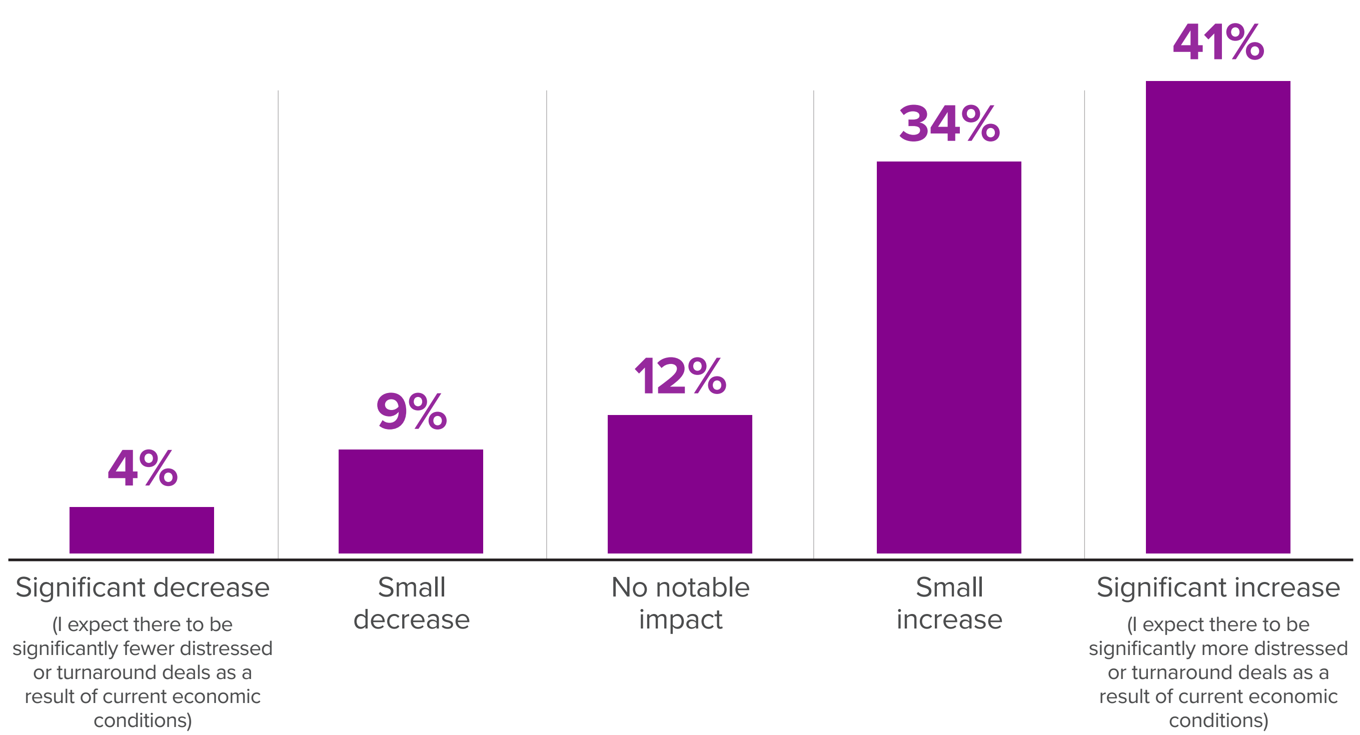
Why do you expect this increase in M&A activity?

- Current earnings are increasing **21%**
- Rising interest rates **18%**
- Concerns about inflationary pressure **14%**
- Aging business owners seeking to sell **14%**
- General U.S. economic conditions **11%**
- Current earnings are stable **9%**
- Concerns about declining valuations **7%**
- Current earnings are decreasing **3%**
- Concerns/uncertainties surrounding COVID-19 . . . **2%**
- Geopolitical tensions **1%**

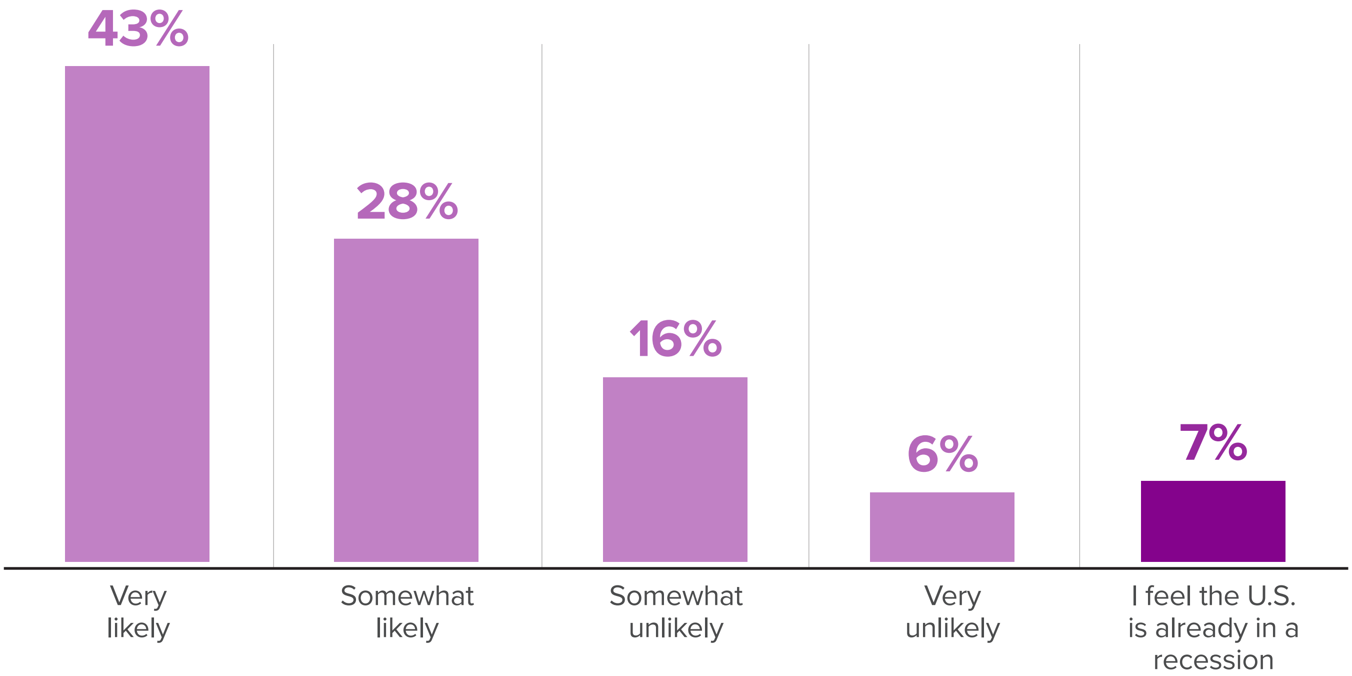
How do you believe the 2023 volume of the following transactions will compare to the 2022 volume?



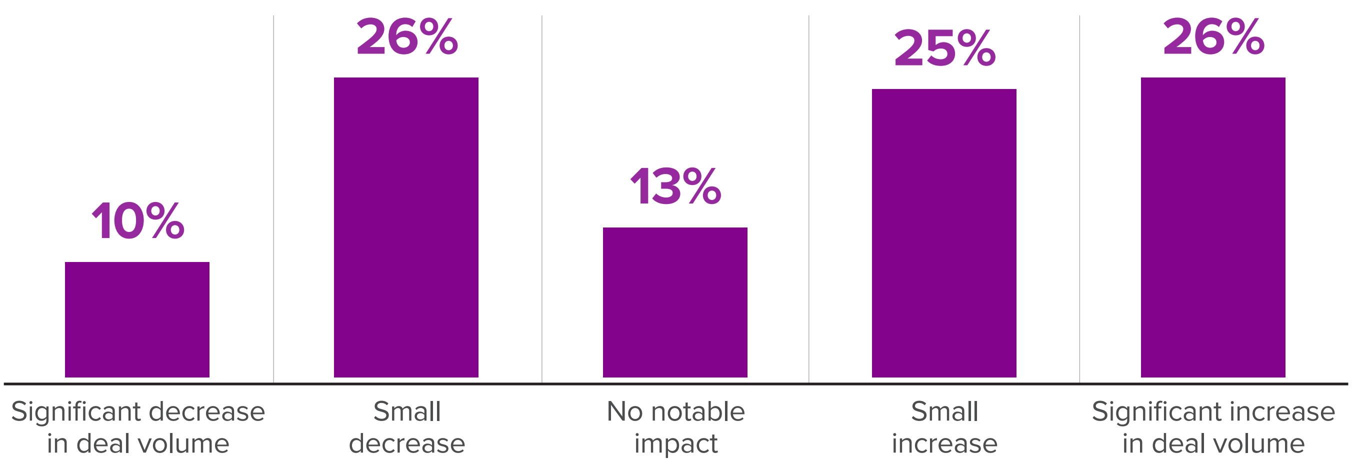
How will current economic conditions impact the number of distressed or turnaround deals in the next 12 months?



How likely is a recession in the U.S. within the next 12 months?



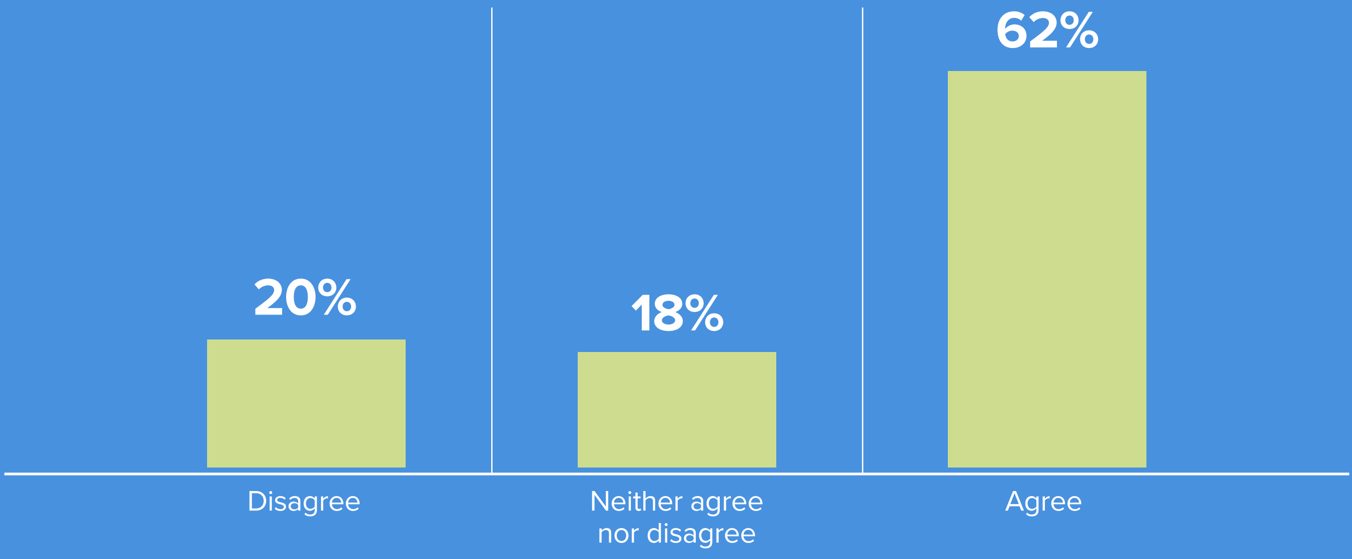
Assuming a recession in the U.S. occurs in the next 12 months, how will it impact U.S. deal activity?



SPAC Market Experiences Slowdown but Solidifies

In a turnaround from last year's high-flying market for special purpose acquisition company (SPAC) mergers, U.S. SPAC IPO deal value tumbled from $106 billion during the first half of 2021 to just $11.6 billion in this year's first half. Many SPAC transactions that were slated to take place in 2022 have been aborted, rising redemption rates for completed SPACs have left less cash on hand to complete acquisitions, and some SPAC sponsors have let their SPACs expire and returned funds to investors. SPACs have also garnered much attention from Washington, D.C., with regulatory bodies ramping up their scrutiny of key market actors. Consequently, optimism for SPAC IPOs waned heading into 2023: While last year 81% of respondents believed SPAC IPOs would be strong in 2022, this year 62% believe the same over the next 12 months. However, deals are still getting done, and respondents believe this sector of the M&A market is here to stay.

Please rate the level to which you agree with this statement:
"U.S. SPAC IPO activity will be strong through 2023."



Inflation, Geopolitical Tensions Still Pose a Threat

Economic uncertainty cast a large shadow over last year's dealmaking landscape. Forty-seven percent of respondents cited rising interest rates as the chief hurdle to closing deals last year, with general economic conditions ranking second at 38%—a drop of 17 percentage points from the prior year—and inflationary pressures following close behind. This doesn't mean dealmakers aren't concerned about the overall state of the economy—these cited hurdles are interconnected parts of the broader economic picture.

These factors also impacted dealmaking in various ways over the course of the year. Forty-three percent of respondents said macroeconomic conditions delayed deals that were ultimately pushed through, while 19% said those conditions aborted deals, and another 19% saw no impact. It's possible that this reflects an increase in retrading of purchase prices and terms, with more focused, intense due diligence in order to get deals closed.

Looking ahead to 2023, dealmakers anticipate that inflation will continue to pose the top challenge to M&A, with 44% of respondents citing it as a concern. Geopolitical concerns, such as the Russian invasion of Ukraine and tensions with China, have also become a principal concern, with 32% of respondents citing both conflicts as challenges. This comes as no surprise, as the Organization for Economic Cooperation and Development anticipates the war in Ukraine will cost the global economy $2.8 trillion in lost output by the end of next year.

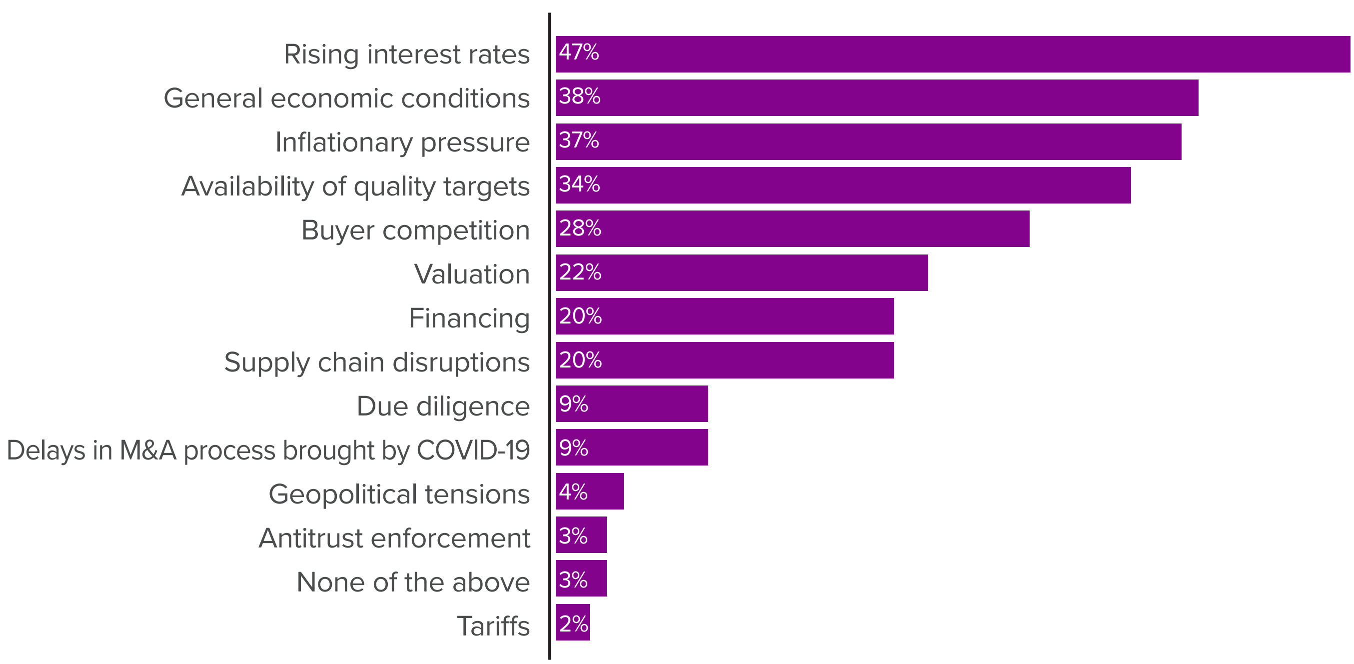
The tough combination of rising interest rates and heightened inflation is expected to reshape both deal terms and how transactions come together—or fall apart. When asked about how these two factors could impact dealmaking in the next 12 months, 46% of dealmakers expect an increase in alternative payment types—such as seller financing and earnouts (contractual provisions promising compensation to sellers contingent on the achievement of financial goals)—and 42% of them anticipate lower deal values and less access to capital. Once again, all of these factors are interrelated; an earnout can be useful if the parties are having difficulty reaching an agreement on an upfront cash price, and when capital is scarce, these payment types can help push deals over the finish line.

Meanwhile, despite (or perhaps in part due to) inflationary pressures and geopolitical turmoil, financial and strategic U.S. buyers are viewed as most influencing U.S. deal valuation by 52% and 35% of respondents, with financial and strategic foreign buyers trailing at 10% and 3%. These findings suggest that the relative strength of the U.S. economy has kept many U.S. buyers investing in U.S. deals, while the increased cost for foreign buyers in completing deals in the U.S. has reduced their influence on the market.

Sixty percent of respondents expect to see an increase in outbound M&A activity from U.S. buyers into Canada and Mexico, and 52% expect the same for Europe. Similarly, 70% of dealmakers expect to see an increase in inbound M&A from Canada and Mexico, and 53% expect the same for Europe. The proximity of Canada and Mexico to the U.S. and the relative strength of the U.S. economy contribute to those perspectives. In addition, the record drop in the pound and the slumping euro are sure to entice American dealmakers into targeting European assets in 2023. Rallying on the back of rising interest rates, the U.S. dollar is exceptionally strong compared to other currencies. The result? Dealmakers around the world are less inclined to invest in emerging global markets and keener to reap greater returns on deals backed by U.S. currency.

In contrast, COVID-19-related concerns have receded as restrictions have been lifted around the world. In a stark reversal from 2021's survey, respondents this year ranked uncertainties about COVID-19 second to last as an M&A driver—a substantial drop from last year, when it ranked second overall. In addition, when it came to M&A deterrents on the horizon for the coming year, almost none chose COVID-19 concerns. As pandemic-related lockdown measures have largely subsided around the globe (with the exception of China), dealmakers' focus may be turning to other, more pressing headwinds.

What are the three most common obstacles you have experienced in deals in the past 12 months?



How, if at all, have macroeconomic conditions, such as heightened inflation, rising interest rates, and recession fears, impacted your company's dealmaking in the last 12 months?

8% Deals were aborted

11% Deals were delayed and later aborted

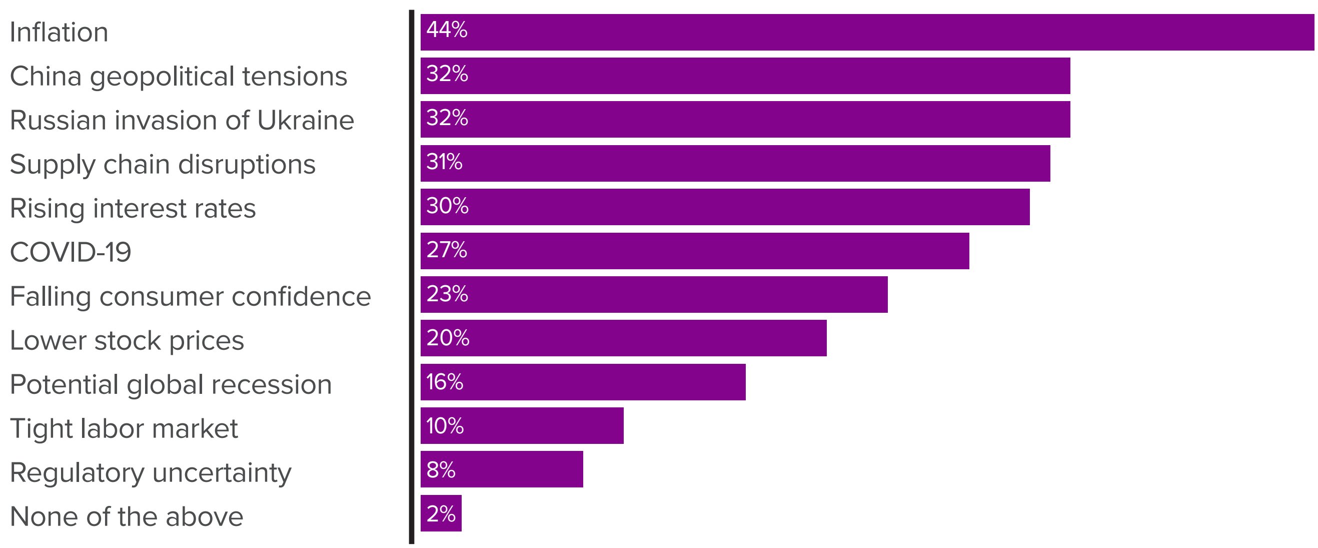
31% Deals were delayed but pushed through with renegotiated or updated deal terms

12% Deals were delayed but pushed through with original deal terms

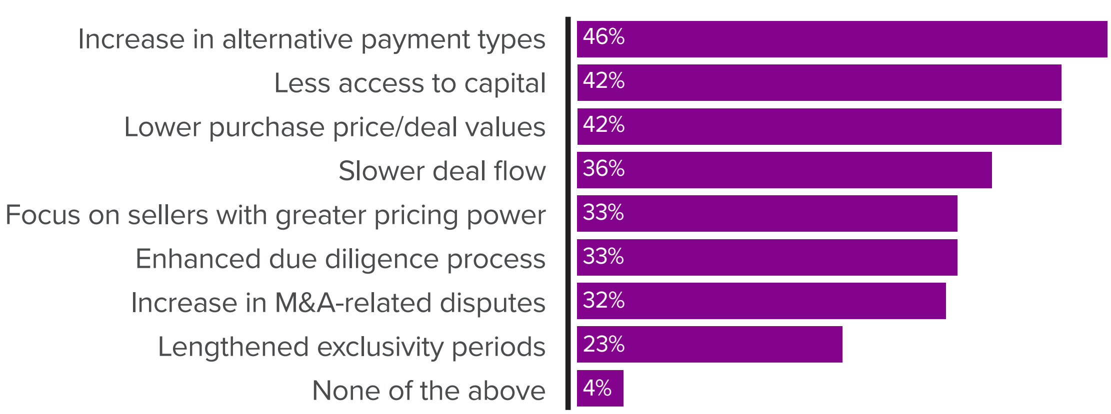
19% Deals were accelerated

19% Not at all

Which of the following pose the top challenges to M&A over the next 12 months?



How do you expect the combination of rising interest rates and heightened inflation to impact dealmaking over the next 12 months?



Midterm Elections and Biden's Agenda a Wash for Dealmakers

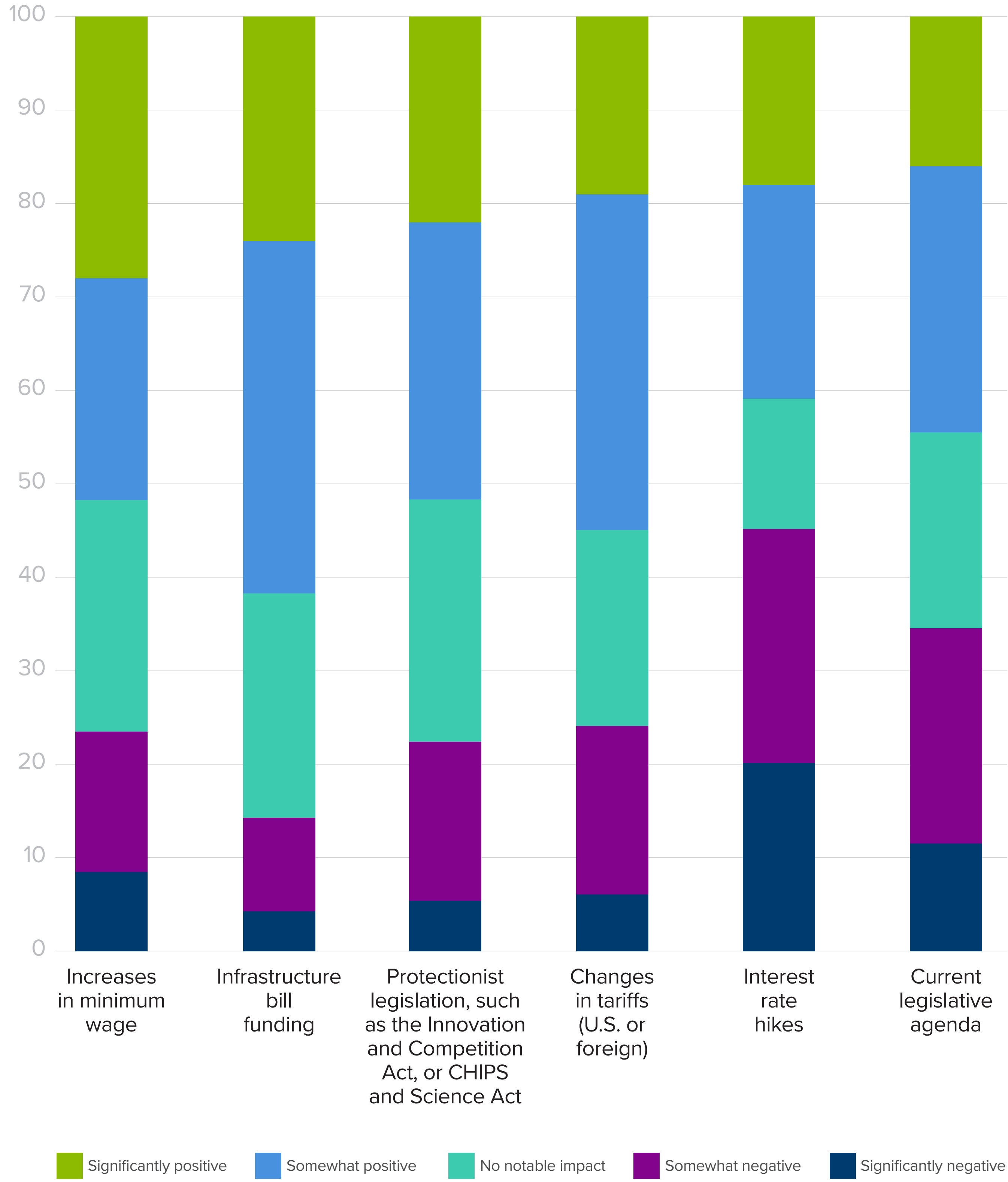
In our 2021 survey, 72% of respondents believed President Biden's agenda would have a positive impact on the M&A market. But in the ensuing year, his administration took broad steps to regulate the M&A market, assembling one of the most aggressive antitrust teams in decades and issuing an executive order containing 72 initiatives meant to increase the scrutiny of mergers and encourage competition. It follows, then, that fewer than half (45%) of dealmakers view Biden's current legislative agenda as positive for the 2023 M&A market, and 34% expect a negative impact on the market.

Moreover, two specific elements of Biden's agenda—the 2021 Infrastructure Investment and Jobs Act and changes in both domestic and foreign tariffs—topped this year's list of political issues expected to have a positive impact on M&A, at 62% and 55%, respectively. Other Democratic policies, such as minimum wage increases and protectionist legislation—which includes the Innovation and Competition Act and the CHIPS and Science Act—also followed close behind. In contrast, interest rate hikes—a hallmark of the Federal Reserve's strategy to curb inflation—are seen as the most likely factor to negatively impact M&A next year.

In another mixed signal for M&A over the coming year, a majority (57%) of respondents believe a Republican-controlled House and Senate would have a positive impact on the M&A market. Forty-eight percent of respondents, however, anticipate a positive impact from either a Democrat-controlled House and Senate or a Democrat-controlled House with a Republican Senate. Unfortunately, a Democrat-controlled Senate and a Republican controlled-House—one of the most probable scenarios according to recent analyses by the political and news site FiveThirtyEight—was viewed the least favorably at 44%. Still, the gap between these percentages isn't wide, and the overall split suggests that dealmakers generally do not see M&A being significantly impacted by the midterms.

Dealmakers Torn on the Midterms

Please rate the likely impact of each of the following potential political issues on the U.S. M&A market in 2023.



Spotlight on ESG Considerations

Environmental, social, and governance (ESG) criteria have continued to gain prominence amid global energy supply disruption. This year the number of firms that specialize in assessing ESG capabilities among M&A targets hit its highest level since 2017, and the Securities and Exchange Commission took measured steps toward establishing ESG disclosure requirements.

Not surprisingly, ESG risk-screening is likely to remain a focus for dealmakers over the coming year, with nearly two-thirds stating that it is likely their company, one of their portfolio companies, or a company they advise will work on a deal in which the target company or buyer is screened for ESG.

In the next 12 months, what is the likelihood that your company, one of your portfolio companies, or a company you advise, will work on a deal in which the target company or buyer is screened for ESG risk?

29%	35%	18%	9%	9%
Very Likely	Likely	Neither likely nor unlikely	Very unlikely	Unlikely

M&A Activity by Sector

According to our respondents, the financial services, energy, and automotive sectors are likely to see the most M&A activity in the next 12 months, with financial services rising to the top spot from third place in 2021 and the automotive sector dropping to third in respondents' rankings—a break from that sector's four-year trend of leading the pack. But despite some shifts among the highest-ranked sectors, the top five largely are the same as last year—with the exception of cannabis, a new addition to our survey this year.

Federal regulatory authorities have continued to take a hands-off approach to the cannabis industry, though for how long that continues remains uncertain. The sector is now projected to reach $33 billion in sales this year as investors and lenders become more comfortable engaging in deals within the industry. That growth continues despite constraints, including federal laws restricting the transport of cannabis and financial transactions.

While cannabis earned a top-five spot in our list this year, the tech industry slipped significantly. Following widescale layoffs and tumbling share prices, the sector dropped from fourth to eighth place year over year. Public markets have substantially turned away from young tech companies that have gone public before turning a profit, and in turn, these companies have lost substantial portions of their market capitalization relative to other industries. Concordantly, private equity and venture investors have been unable to sell or go public at the multiples they have seen in prior periods.

In the automotive sector, respondents view the push toward electric, low-emission, and new energy vehicles as the top driver of activity. Given that the Biden administration recently enacted legislation to expand the build-out of electric vehicle infrastructure and the industry's clear focus on this sector, dealmakers likely expect further maturation and adoption of burgeoning EV technologies.

Dealmakers also expect regulatory pressure to reduce emissions will drive energy sector M&A activity next year. But ESG-related factors are only part of the equation: Almost half of respondents also expect high commodity prices will fuel deal activity. The war in Ukraine and recent cutbacks on OPEC production levels have generated renewed interest in domestic oil and gas production, and the push for additional fossil fuel supplies could create opportunities for oil and gas dealmakers looking to cash in on rising prices.

The healthcare sector continued to experience strong M&A activity on the heels of the pandemic, which accelerated the adoption of telehealth and related technologies. That's expected to boost deal activity in the sector in the coming year, with alternative care models and emerging digital health products viewed as the primary drivers of M&A in healthcare.

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

2021		2022
Automotive	1	Financial Services
Energy	2	Energy
Financial Services	3	Automotive
Technology, Media, and Telecoms	4	Healthcare
Healthcare	5	Cannabis

Which **automotive** trends will drive M&A activity in the sector?

1

67%

Push toward electric, low-emission vehicles, or new energy vehicles (NEVs)

2

47%

Increased focus on infrastructure needed for NEVs

3

37%

Push toward autonomous vehicles

Which **energy** trends will drive M&A activity in the sector?

1

57%

Regulatory pressure to invest in renewable energy and carbon capture and storage

2

49%

High commodity prices

3

45%

Inflation Reduction Act and associated funding to support renewable energy development

Which **healthcare** trends will drive M&A activity in the sector?

1

54%

Increased emphasis on alternative care models, such as home or virtual care

2

52%

Emerging digital health products, such as electronic health records or wearable devices

3

44%

Continued focus on behavioral and mental health

Methodology

In September 2022, national law firm Dykema Gossett PLLC distributed its M&A Outlook Survey via email to a group of CEOs, CFOs, and other senior company officers and executives, as well as professional advisors engaged in the M&A industry. The survey respondents represent a cross-section of executives and M&A advisors engaged in more than a dozen sectors, including technology, media, financial services, industrial/manufacturing, real estate and construction, healthcare, energy, automotive, and education. Respondents represent companies with annual revenues from less than $1 million to more than $1 billion. Due to rounding, percentages used in some questions may not add up to 100%.

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