Dykema

M&A

19th Annual
Mergers & Acquisitions
Outlook Survey

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Welcome to Dykema's

19th Annual M&A Outlook Survey

We have 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 mergers & acquisitions (M&A)-related activity at their respective firms—to get their outlook on the M&A market over the next 12 months.

We hope you will find the following report valuable as you navigate the M&A environment in the coming months. We thank all survey respondents for their time and insights.

Sincerely,
The Dykema Mergers & Acquisitions Annual Outlook Survey Team

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Executive Summary

State of the M&A Market: Dealmakers Find Stable Ground Amid Economic Uncertainty

Dealmakers continue to find solid footing in today's U.S. M&A market, adapting to a strained financing environment, stubborn inflation, and higher interest rates by increasing their use of creative financing arrangements and focusing on add-on and smaller deals. And while the soaring deal volume of 2022 has wound down by almost a third, business leaders anticipate a steady deal market in the year ahead.

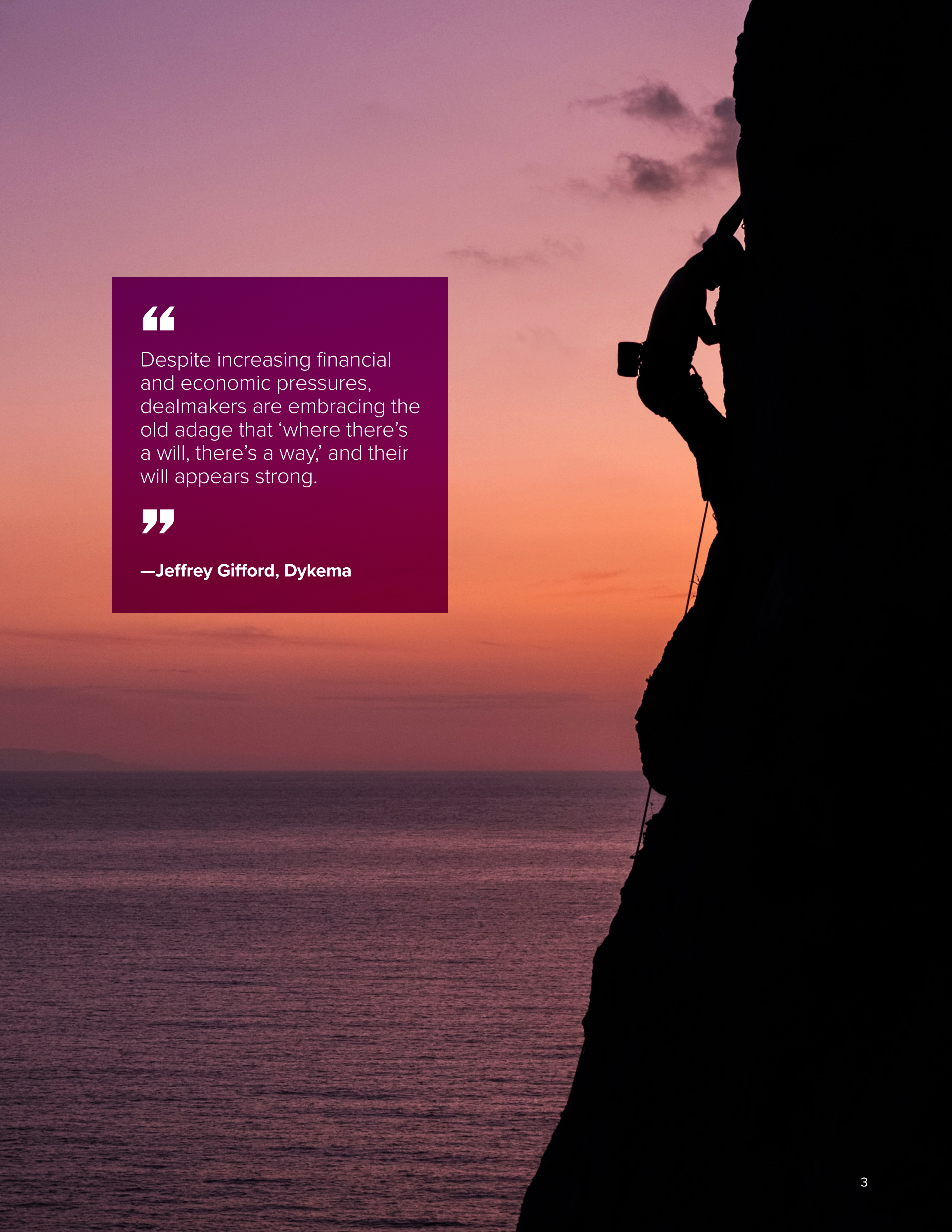
Dykema's 19th Annual M&A Outlook Survey, based on responses from over 260 executives and financial advisors, shines a light on this persistent resilience. The majority of respondents (57%) expect the U.S. M&A market to strengthen in the next 12 months—down just eight percentage points from 2022. Meanwhile, a quarter of dealmakers—nearly double the share from last year's survey—believe the market will remain the same, and only 18% expect it to weaken versus 22% from 2022. The tempered outlook seems to reflect a growing consensus that despite few bright spots in the M&A market and broader U.S. economy, dealmakers can expect much of what they saw in 2023 to continue into 2024.

Today's headwinds are real. With a weaker pipeline of megadeals and valuation expectations shifting, some dealmakers are feeling the pinch: Private equity (PE) firms now have $1.5 trillion of dry powder on hand and limited opportunities to deploy it. Yet in response, M&A players of all sizes have begun to pursue smaller deals, which pose less risk and are easier to finance. Over half of respondents predict that small-market deal volume will increase in the next year, and 43% expect an increase in midmarket deal volume; only 12% anticipate a decline next year in small-market deal volume, with 16% predicting a decline in the midmarket. To get these deals across the finish line, executives have started seeking alternative funding arrangements and expect to work on more transactions featuring at least some seller financing.

Fortunately, when it comes to expectations for the U.S. economy at large, dealmakers remain optimistic—if markedly more tempered than they were last year. Half of respondents say they have a positive outlook on the economy, a finding that has hardly changed from last year's report. But the percentage of respondents who hold a neutral outlook has increased substantially—swelling by 14 percentage points to 33%—and just 17% of dealmakers articulate a negative economic outlook. As is the case with the M&A market, our respondents expect more of the same from the broader U.S. economy heading into 2024.

Overall, as the following report illustrates, respondents have settled into a slightly quieter market, in which M&A players are pursuing fewer deals and less frequently rushing to capture hot targets. Interestingly, although dealmakers have expressed reservations about artificial intelligence (AI), an overwhelming majority view this breakthrough technology as a potential boon for both the dealmaking process and enterprise value creation. Another factor that dealmakers are contending with is the more aggressive antitrust stance taken by the Biden administration.

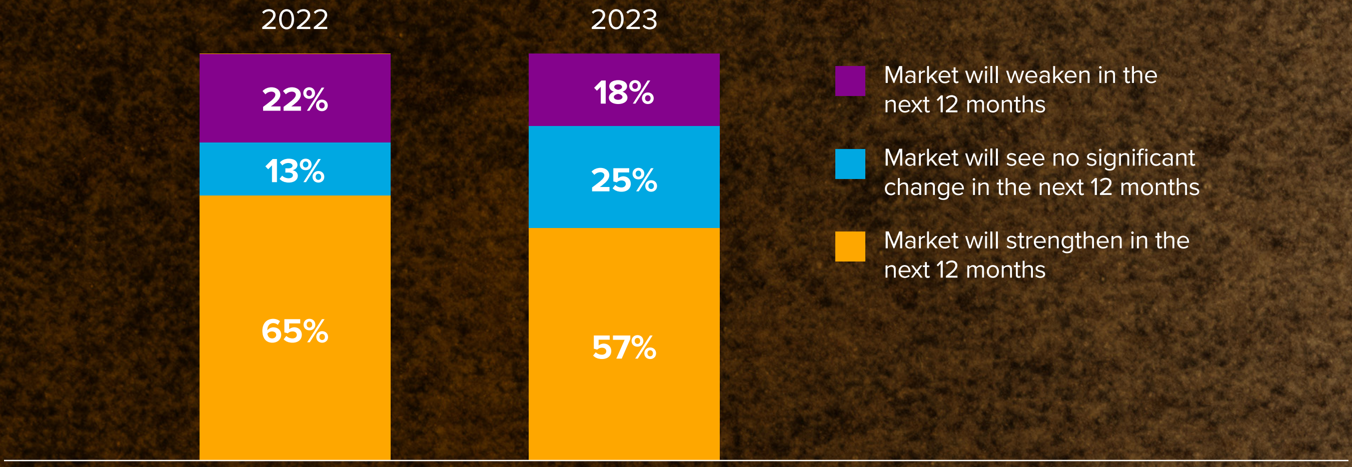
Most importantly, dealmakers continue to forge new strategies that drive M&A activity—and appear confident in their ability to navigate ongoing hurdles like inflation, tighter lending requirements, and a less sanguine outlook on the overall economy.



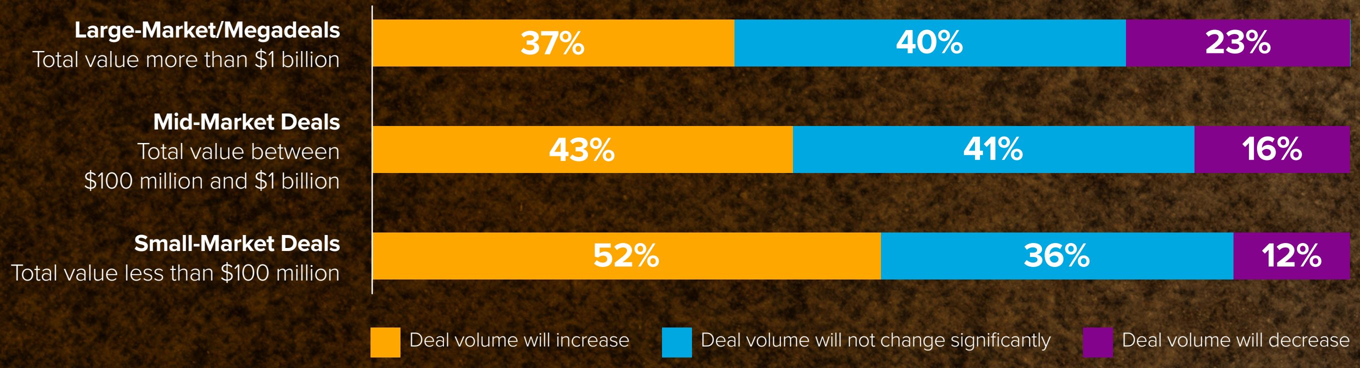
> Despite increasing financial and economic pressures, dealmakers are embracing the old adage that ‘where there’s a will, there’s a way,’ and their will appears strong.
>
> **—Jeffrey Gifford, Dykema**

Dealmakers Move Forward With Cautious Optimism; Fewer Anticipate M&A Market Swings

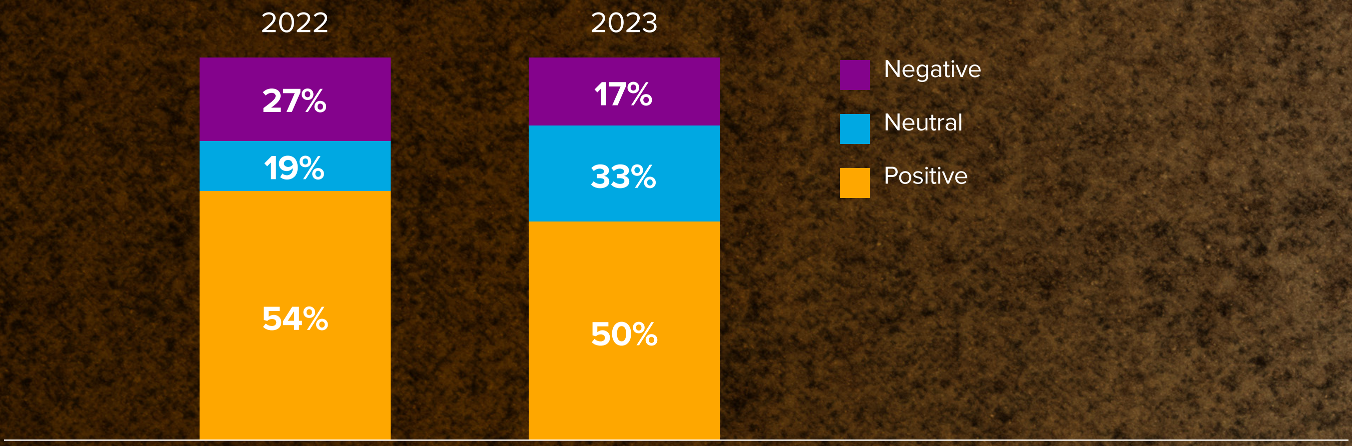
How will the U.S. M&A market for the next 12 months compare to the past 12 months?



What is your prediction for the volume of small, midmarket, and large-market/megadeals in the next 12 months compared to the previous 12 months?



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



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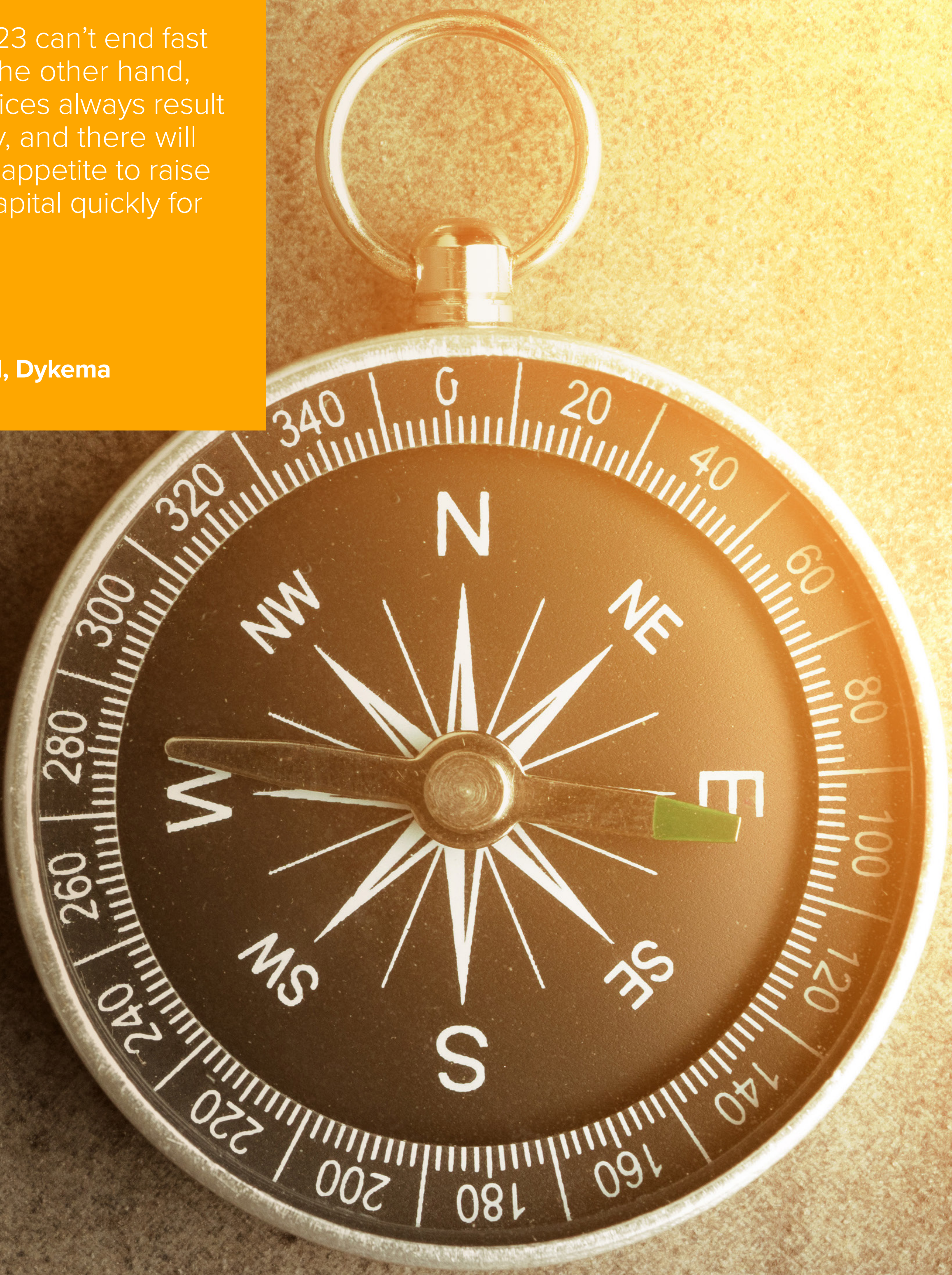
For many, 2023 can’t end fast enough. On the other hand, depressed prices always result in opportunity, and there will always be an appetite to raise and deploy capital quickly for quality deals.

”

—Mike Bernard, Dykema



Key Trends and Findings

Despite Financing Challenges, Dealmakers See Improved M&A Activity Ahead

- Dealmakers cite inflationary pressure, heightened interest rates, and general economic conditions as their most significant obstacles over the past year—and anticipate those obstacles will remain in place for 2024
- According to respondents, the top three factors likely to spur M&A activity in 2024 are improved financial markets, availability of capital, and inflation moderation

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Economy and Dealmakers to Stay Resilient as Conditions Improve

- Half of respondents expect a positive shift in the U.S. economy, a third anticipate no meaningful change, and only 17% believe the economy will worsen
- Almost half of dealmakers say third-party equity investments have become more common, and nine in ten have worked on deals involving seller financing within the past year

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With Fewer Opportunities, Dealmakers Focus on Identifying the Right Deals, Executing With Care

- More than two-thirds of respondents report spending more time in due diligence and experiencing delays in deal completion over the past year, and a majority expect the slowdown to continue in 2024
- 89% of dealmakers report working on deals in which R&W insurance was involved during the past 12 months
- Close to three-quarters of dealmakers say it is likely they'll be involved in a transaction in which the buyer or target company is screened for ESG risk

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Artificial Intelligence Expected to Help Assess and Source Deals

- Three in four dealmakers believe AI will have a meaningful impact on M&A processes and efficiencies
- Seventy-one percent of M&A dealmakers anticipate acquiring companies offering AI capabilities, or those that successfully implement AI solutions in their businesses, in the next year

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Three Sectors Likely to See Significant Deal Activity

- This year, respondents view energy, financial services, and healthcare as the sectors most likely to see M&A activity in the next 12 months
- Energy: Roughly half of dealmakers rank high commodity/energy prices, financing tied to the Inflation Reduction Act, and the need for traditional energy infrastructure as the top drivers of energy M&A activity in the coming year
- Financial Services: Over half of respondents say the rise of fintech and innovative banking products—as well as investments in tech, automation, and AI—will fuel financial services deals into 2024
- Healthcare: Dealmakers expect alternative care models, medtech, and emerging AI solutions and platforms to boost healthcare M&A activity over the next year

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Despite Financing Challenges, Dealmakers See Improved M&A Activity Ahead

Dealmakers faced several obstacles last year, but many seem to have found deals they could get done. Over the next 12 months, dealmakers intend to stay the course, hoping for an improved deal environment next year.

Inflation remains elevated over recent historical standards. Despite the Federal Reserve's best efforts to quell it via interest rate hikes—which seem to have helped substantially reduce the rate of inflation—the inflation rate is still above the Fed's 2% target. There may be further rate hikes in the future and a significant period of time before rates are reduced. In fact, Wall Street has been projecting another rate hike before year-end and sustained, high interest well into 2024.

It's perhaps unsurprising, then, that respondents cited inflationary pressure (44%), heightened interest rates (40%), and general economic conditions (30%) as their most significant obstacles over the past year. Given the uncertainties noted above, it seems dealmakers don't envision much change going forward, viewing those three as top challenges for 2024 as well.

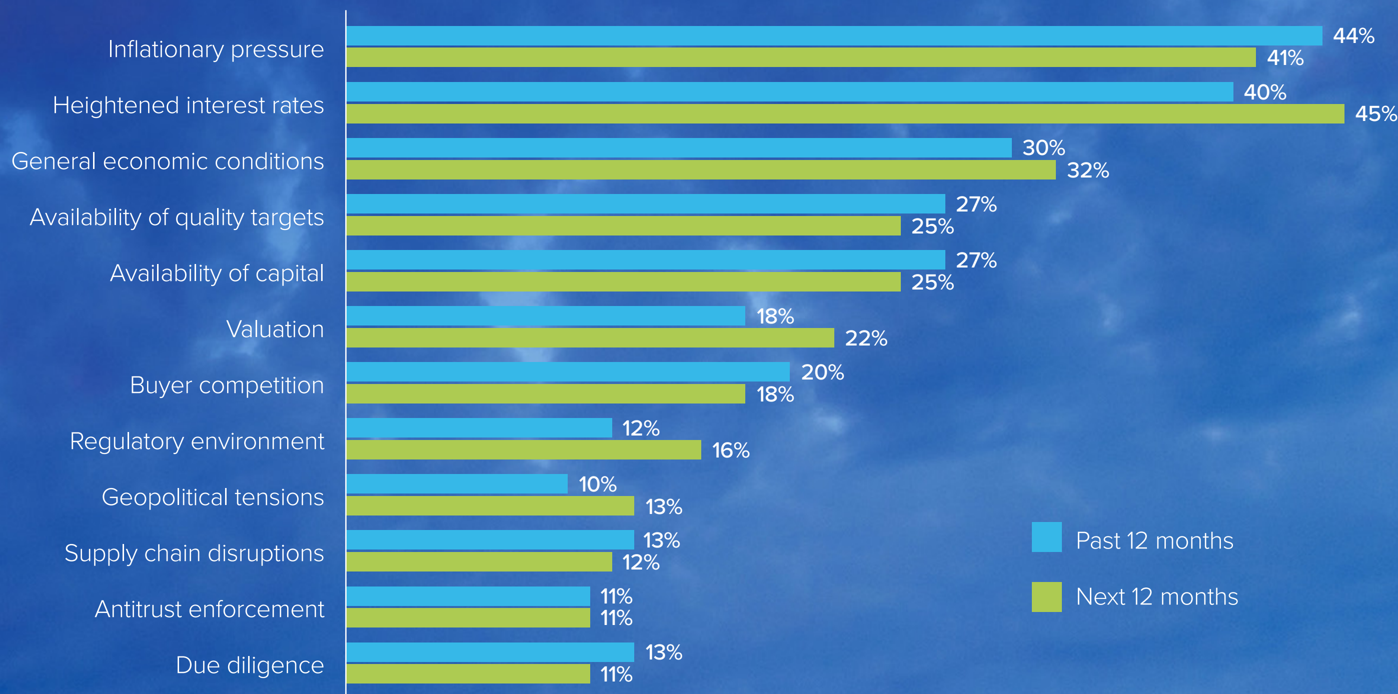
Higher interest rates are having a particular impact on PE firms, whose portfolio companies are experiencing increased financial stress due to these higher interest rates, making it more expensive to service their debt. With banks becoming more reluctant to finance larger deals like platform acquisitions for borrowers that have become less creditworthy, some PE firms have turned to alternative funding arrangements to get deals across the finish line, including greater use of nonbank lenders, preferred equity, seller financing, and mezzanine loans.

Other respondents have pivoted to smaller deals. In 2023, PE-backed deals have averaged around $65.9 million—their lowest value since the Great Recession. Dealmakers expect this trend to continue, with more than half of respondents anticipating small-market deal volume to increase over the next 12 months and 43% expecting midmarket deal volume to do the same. That's compared to just 37% of dealmakers who expect large-market deal volume to increase.

PE players able to secure sufficient financing may be able to seize this moment by targeting these smaller deals and/or acquiring distressed companies at a discount. Our respondents concur: More than half anticipate an upswing in distressed M&A deal volume in 2024, which may be a factor in the expected rise in overall M&A deal volume compared to last year.

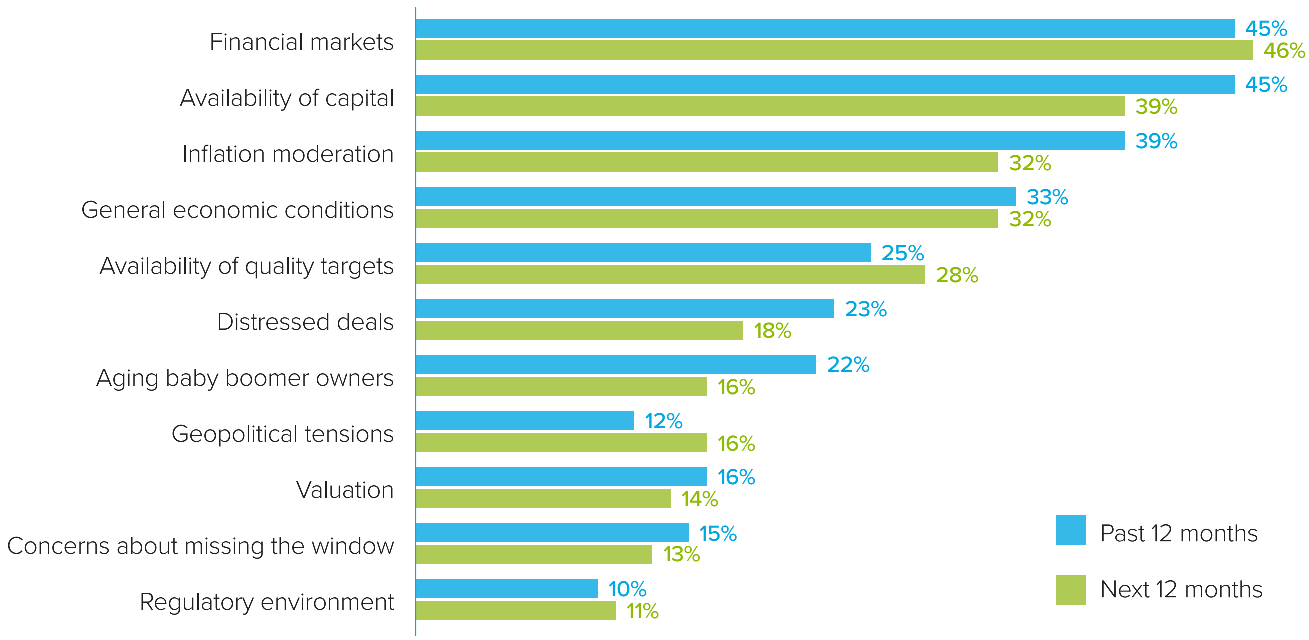
As for deal drivers, respondents cite financial markets (46%), availability of capital (39%), and inflation moderation (32%) as the top three likely factors to spur M&A activity in 2024. When asked what drove deals over the past 12 months, dealmakers also named the same three drivers—but they ranked availability of capital and inflation moderation significantly higher, at 45% and 39% respectively. This difference could suggest tempered optimism that current economic headwinds will ease next year and, in turn, bolster the M&A market. It seems that, for now, dealmakers have learned how to adapt to today's more challenging environment.

Which of the following were/are the top obstacles to M&A over the past/next 12 months?



Deal Volume to Hold Steady Despite Inflation, High Interest Rates

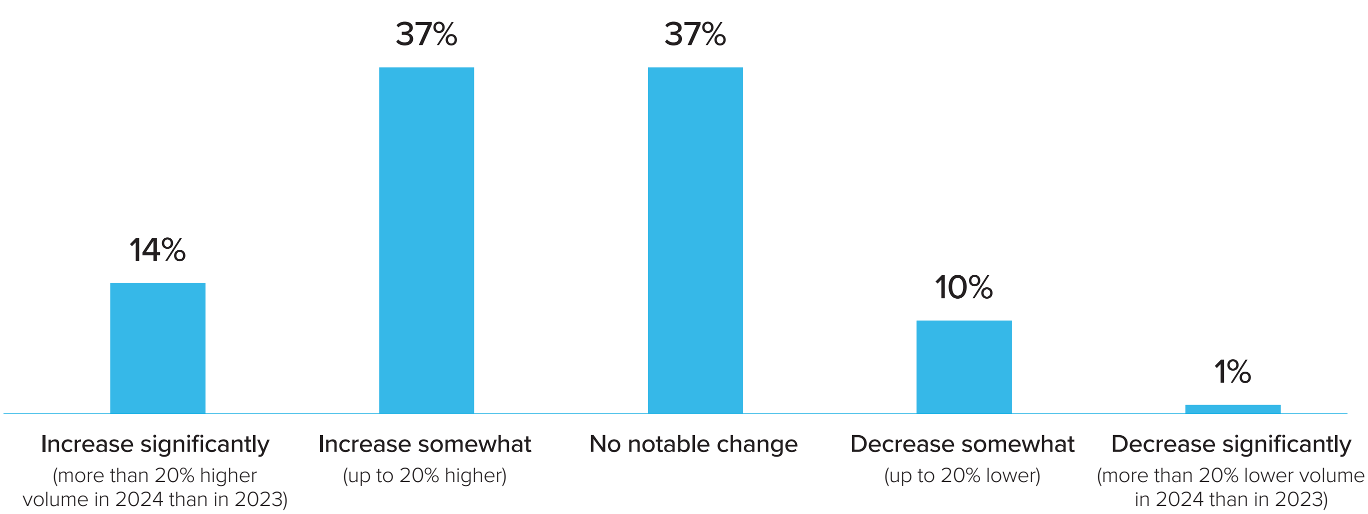
Which of the following were/will be most responsible for driving M&A over the past/next 12 months?



Please indicate your level of agreement with the following statement:
Private equity portfolio companies are experiencing increased financial stress from servicing their debt at higher interest rates.

30%	**56%**	**12%**	**2%**
Strongly agree	Somewhat agree	Neither agree nor disagree	Disagree

How do you believe the overall 2024 volume of distressed M&A will compare to the overall 2023 volume?



> The rapid increase in interest rates has generated a strong gravitational pull on company valuations and deal terms.
>
> **—Nick Monaghan, Dykema**

Economy and Dealmakers to Stay Resilient as Conditions Improve

In line with their overall M&A outlook, dealmakers remain modestly hopeful that the economy will stabilize in the next 12 months, with half expecting a positive shift, and a third anticipating that it will not experience any meaningful change. In addition, only 17% forecast a declining economy, compared with 27% in 2022. This somewhat brighter outlook may be fueled by several positive economic indicators—the S&P 500 has staged an impressive, if inconsistent, rally in the first half of this year; the Fed is putting the brakes on interest rate hikes (for now); and the U.S. inflation rate, while still above the Fed's 2% target, has slowed to 3.7% as of September 2023.

In fact, the strengthening of the U.S. economy in recent months has more dealmakers believing a "soft landing," rather than a recession, will occur.

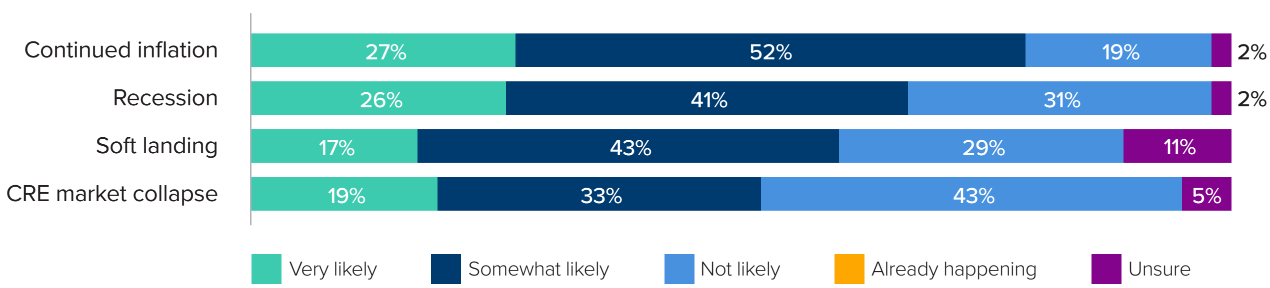
In 2022, 43% of respondents said that a recession was very likely over the next 12 months; that percentage has dropped by 17 percentage points this year. Moreover, six in 10 respondents say a soft landing—a slowdown in growth that steers clear of recession—is likely. This shift may reflect that members of the Fed and leading U.S. economists now seem more sanguine about the future, lowering their expectations of a recession to 55% in August, according to a poll conducted by Reuters.

Responding to Higher Interest Rates

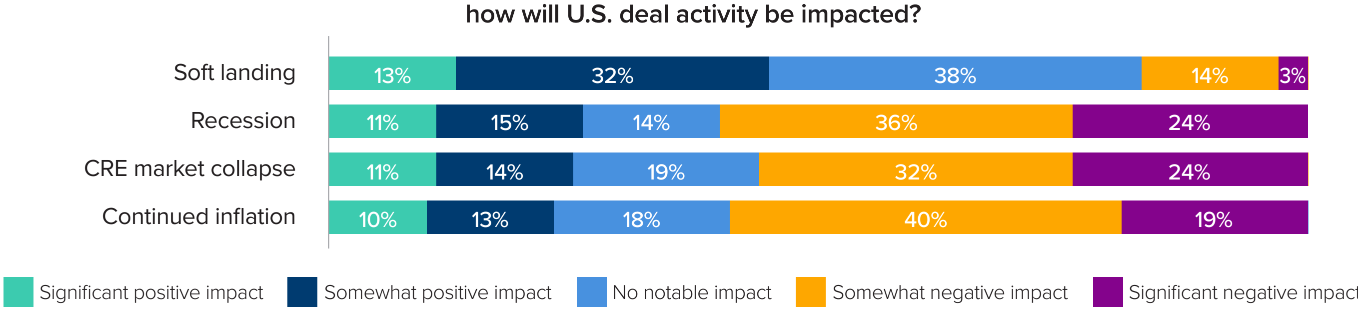
As noted above, dealmakers are altering their financing methods in response to last year's more volatile economic landscape. Almost half say that dealmakers are turning to third-party equity investments to overcome tighter loan availability, while 41% indicate rollover equity has become more prominent.

In addition, seller financing rose in popularity: 90% of respondents report working on a deal involving seller financing during the past year, and 10% say they have never engaged in seller financing. But while these alternative financing options have allowed deals to progress, the speed of getting to closing has lagged over the past 12 months. In fact, respondents agree that deal timelines were extended or delayed due to financing challenges during that time. That said, dealmakers may be less focused on agility in this economic climate and more concerned with advancing deals that present greater certainty and doing more in-depth due diligence.

Please indicate your level of agreement with the following statement in the U.S. over the next 12 months.

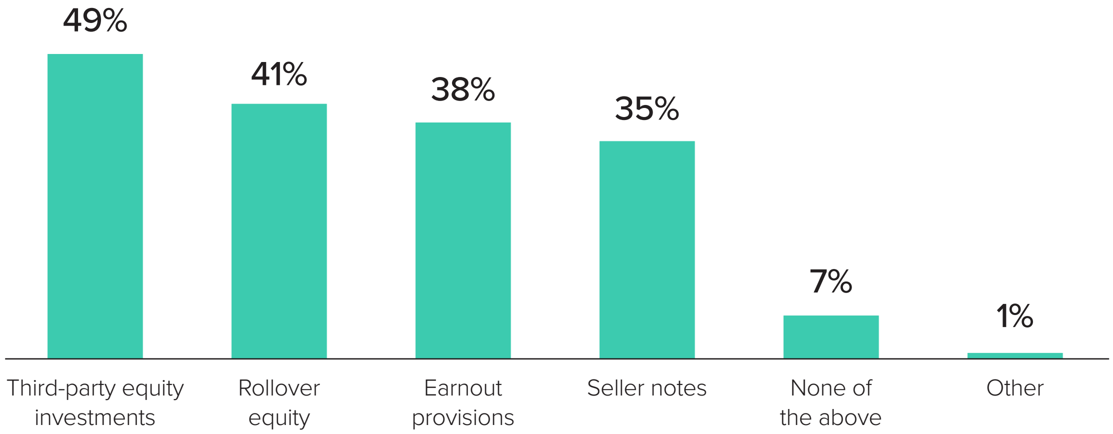


Assuming the following occur independently in the U.S. over the next 12 months, how will U.S. deal activity be impacted?

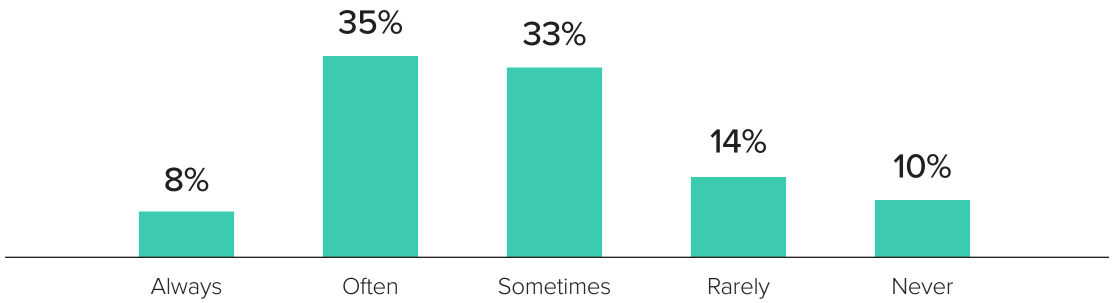


Executives Button Up Deals by Pivoting to Alternative Financing Methods

Which of the following alternative financing methods have become more prominent as a result of decreased loan availability?



Over the past 12 months, how frequently did you work on a deal in which seller financing was involved?



Please indicate your level of agreement with the following statement:
Deal completion timelines have been expanded or delayed due to financing challenges over the past 12 months.

31%	44%	21%	4%
Strongly agree	Somewhat agree	Neither agree nor disagree	Somewhat disagree

> Alternative financing methods have become more prominent over the past year and, in many cases, have been critical to getting deals done. With interest rates expected to remain high, we anticipate this trend to continue.

—Joseph DeHondt, Dykema

With Fewer Opportunities, Dealmakers Focus on Identifying the Right Deals, Executing With Care

While dealmakers expect M&A activity to stay steady, overall deal volume slumped by 4% between the second half of 2022 and the first half of 2023. One possible factor: More than two-thirds of respondents report spending more time in due diligence and experiencing delays in deal completion over the past year, and a strong majority expect those trends to persist into 2024. Between this slowdown in deal completion and a more challenging financing environment, M&A players seem to have become a bit more cautious and deliberate in their dealmaking.

The Continued Presence of Reps and Warranties Insurance

R&W insurance has become quite common for transactions greater than $50 million and has become more common on smaller deals as well. Forty-three percent of dealmakers report that they either always or often worked on deals in which R&W insurance was involved during the past 12 months, while another 32% claim they did sometimes. Further, dealmakers think R&W insurance is here to stay: Only 5% say they expect its frequency to decline in the next year.

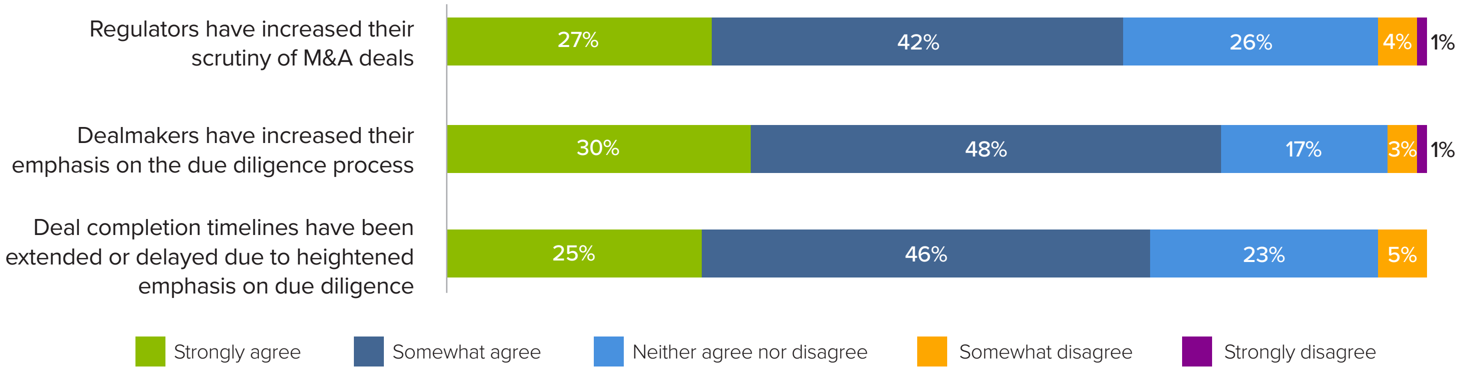
New ESG Disclosure Rules Loom

Dealmakers are also under mounting pressure to meet President Biden's tough stance on environmental regulations. In June, the Biden administration barred a coalition of 25 U.S. states from challenging an environmental, social, and governance (ESG) investing rule, and the Securities and Exchange Commission (SEC) is expected to finalize and implement new ESG disclosure rules around greenhouse gas emissions over the coming months.

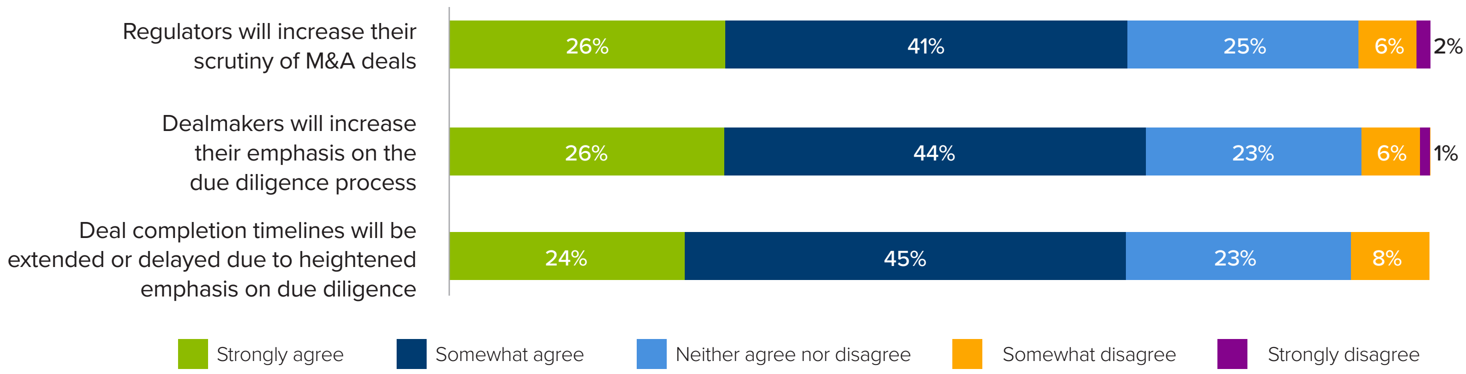
These regulatory developments are expected to bring further complexity to the dealmaking process in the next year. In response, close to three-quarters of dealmakers are saying it is likely they'll be involved in a transaction in which the buyer or target company is screened for ESG risk.

Dealmakers Taking Fewer Risks Amid Heightened Regulatory Scrutiny

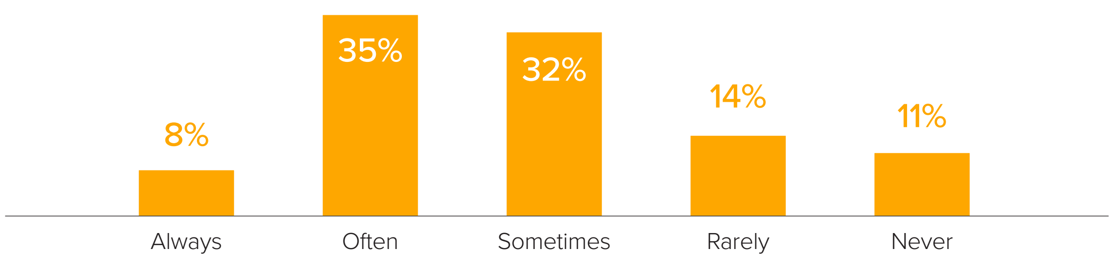
Please indicate your level of agreement with the following statements: "Over the PAST 12 months..."



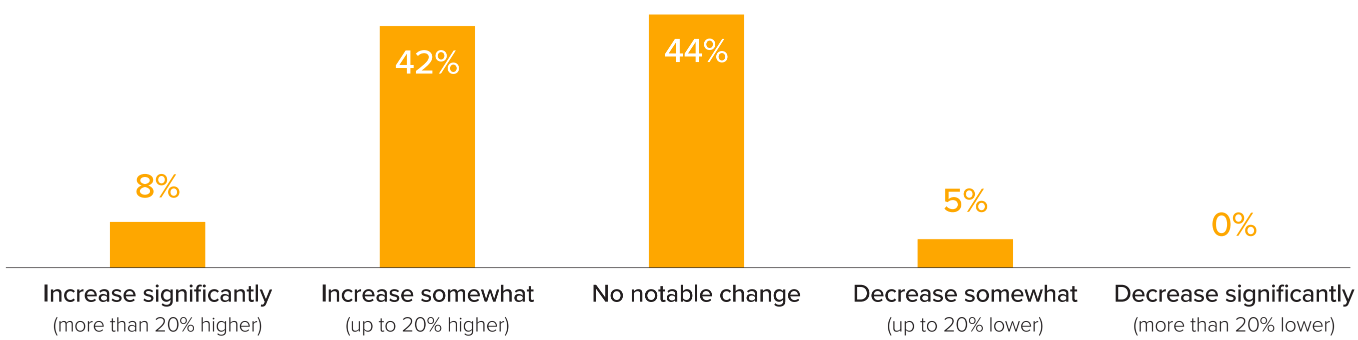
Please indicate your level of agreement with the following statements: "Over the NEXT 12 months..."



Over the past 12 months, how frequently did you work on a deal in which an R&W insurance policy was involved?



What is your expectation for the frequency of R&W insurance in deals over the next 12 months compared to the previous 12 months?



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

23%	49%	19%	9%
Very likely	Somewhat likely	Not likely	Unsure

Artificial Intelligence Expected to Help Assess Deals and Increase Target Company Values

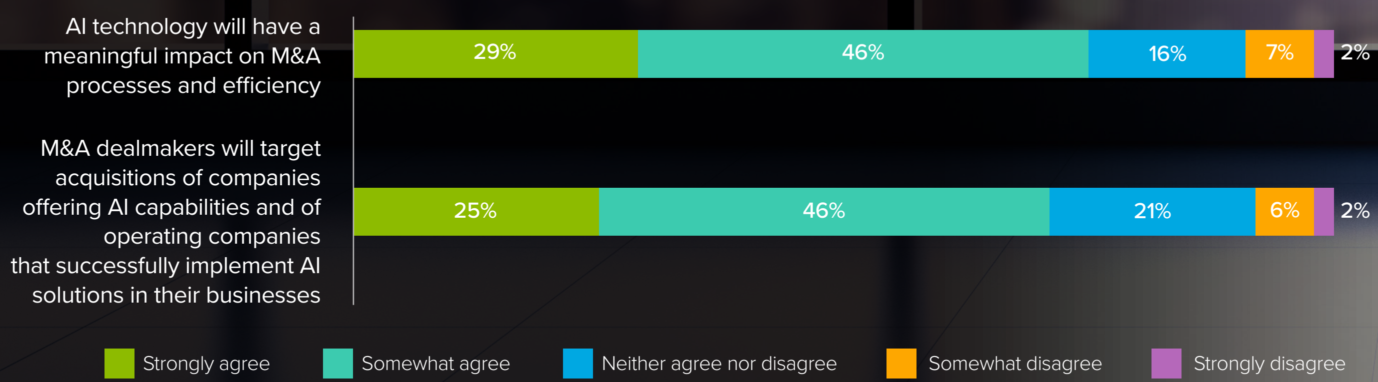
AI is now being deployed at various stages of the M&A lifecycle to accelerate decision-making, streamline due diligence, and source acquisition targets.

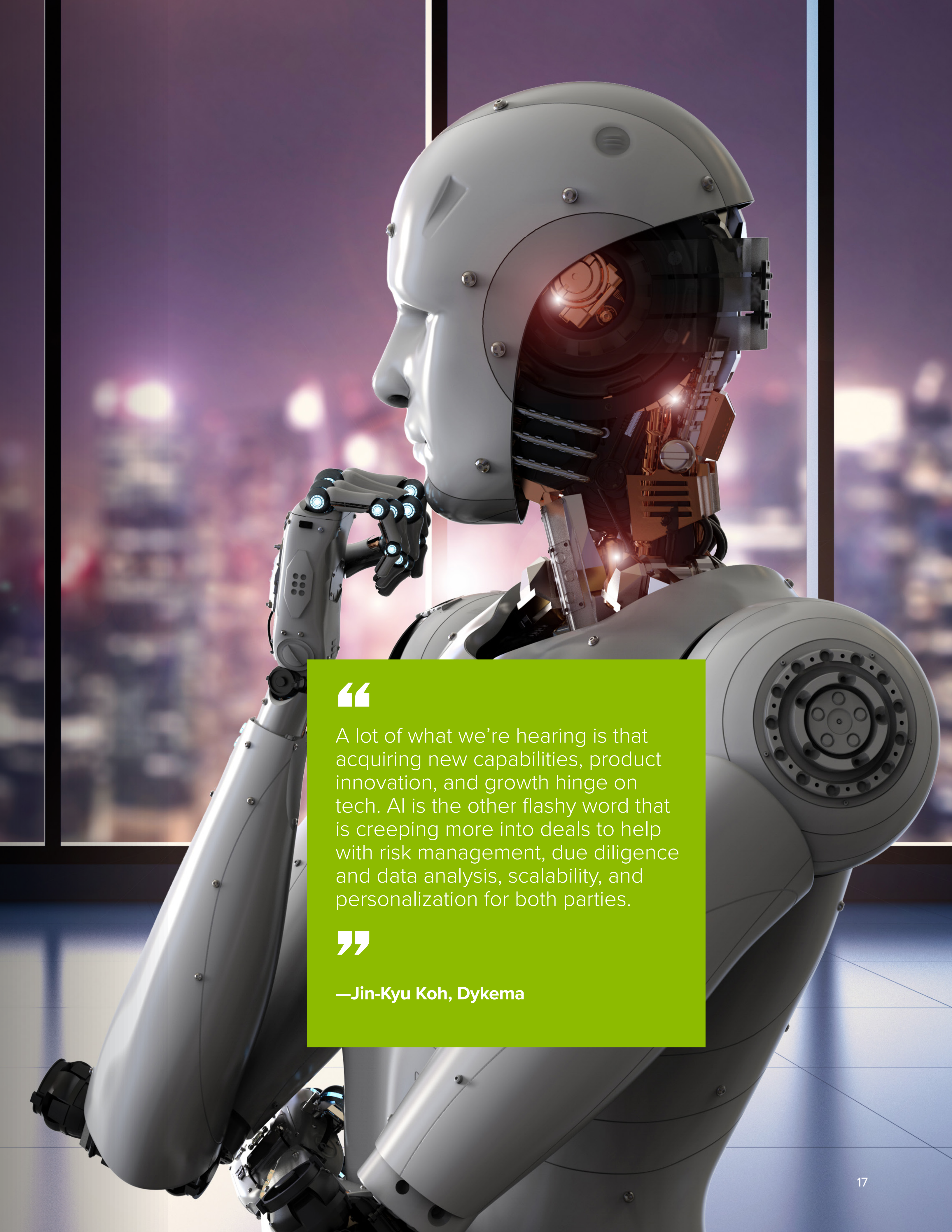
It's little wonder, then, that the overwhelming majority (75%) of dealmakers believe AI will have a meaningful impact on M&A processes and efficiencies, including sourcing new deals. Still, only 34% of respondents believe AI will impact success forecasting, and even fewer (23%) expect it to improve the integration of acquisition targets. The majority of respondents view AI as a tool more likely to impact repetitive processes, such as risk analysis (62%), target screening (49%), deal processing (44%), and deal/valuation analysis (42%). Yet despite signs of promise, dealmakers' reluctance to view AI as broadly transformative to the M&A process might be due to the difficulty of implementing it. Respondents cite a range of challenges to incorporating AI into M&A processes—with ethical and cybersecurity/data privacy ranking the highest. But there is little consensus on which issue poses the most significant challenge to AI implementation. In fact, the top six cited concerns all fall within a range of 12 percentage points.

According to dealmakers, selected investment in automation and AI is one of the top three trends driving M&A activity across multiple sectors, including financial services, healthcare, and manufacturing. In addition, 71% of M&A dealmakers anticipate acquiring companies offering AI capabilities, or those that successfully implement AI solutions in their businesses, in the next year. Further, two-thirds of dealmakers say generative AI—which, unlike predictive AI, is used to generate novel content or data—will strengthen the valuations of companies using this technology over the next 12 months.

These findings underscore the fact that AI is—despite its potential and prominence in cultural and political discourse—still nascent. Many of these issues will need to be addressed before this breakthrough technology sees widespread rollout across the M&A landscape.

Please indicate your level of agreement with the following statements: "Over the NEXT 12 months..."

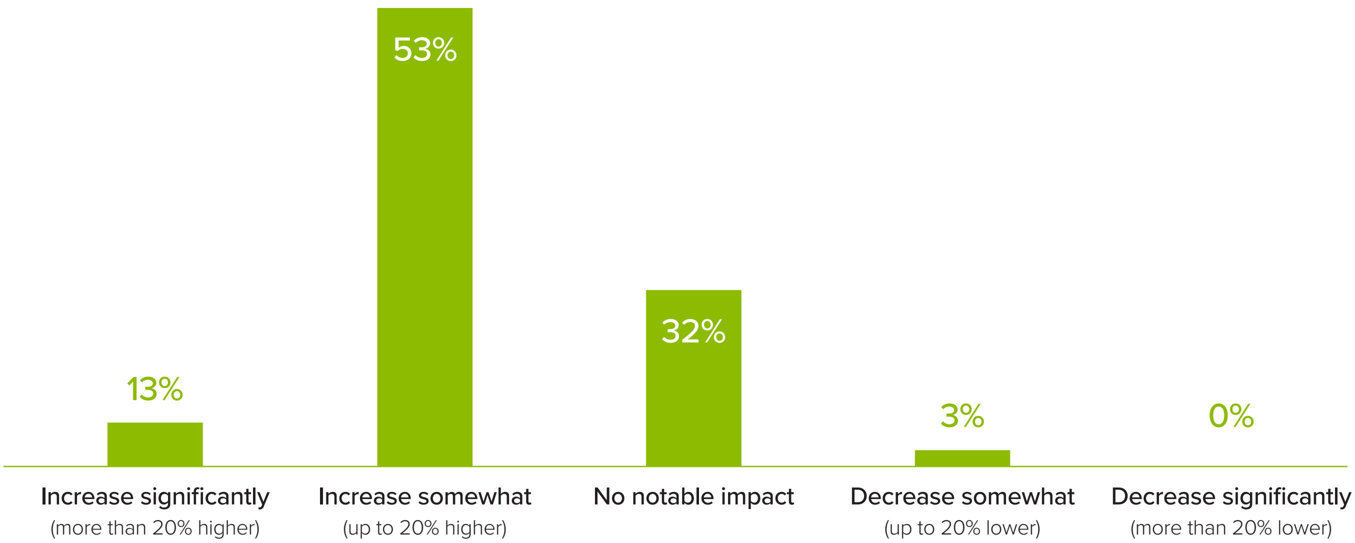




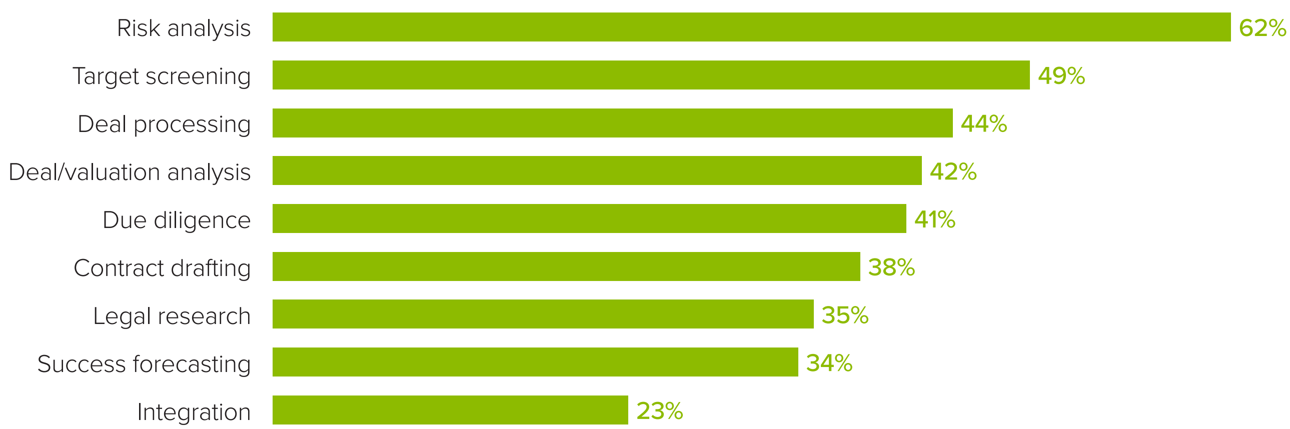
> A lot of what we're hearing is that acquiring new capabilities, product innovation, and growth hinge on tech. AI is the other flashy word that is creeping more into deals to help with risk management, due diligence and data analysis, scalability, and personalization for both parties.

—Jin-Kyu Koh, Dykema

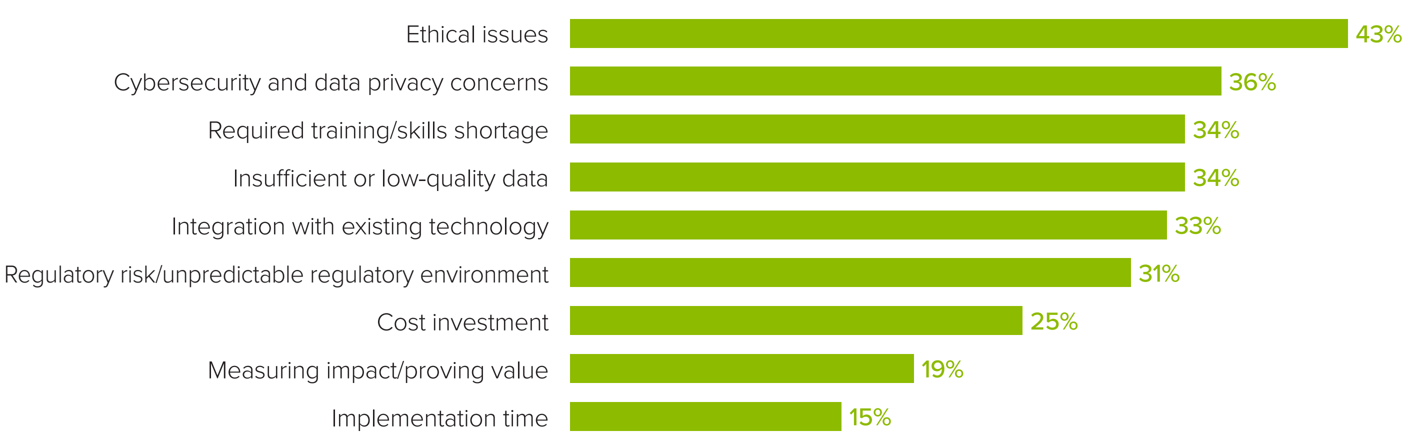
What impact do you expect generative AI technology to have on the value of sellers in M&A transactions over the next 12 months?



Which of the following areas do you expect AI will impact?
Asked of those who agree AI will impact M&A processes and efficiencies



Which of the following do you view as potential hurdles for AI's impact on M&A processes?
Asked of those who do not agree AI will impact M&A processes and efficiencies



M&A Activity by Sector

This year, respondents view energy, financial services, and healthcare as the sectors most likely to see M&A activity in the next 12 months. Compared with last year's sector findings, financial services dropped from first to second place, healthcare rose from fourth to third place, and technology and industrial/manufacturing both moved up into the top five. In addition, two of 2022's leading sectors—cannabis and automotive—dropped out of respondents' top five this year.

2022	Ranking	2023
Financial Services	1	Energy ▲ +1
Energy	2	Financial Services ▼ -1
Automotive	3	Healthcare ▲ +1
Healthcare	4	Technology, Media, and Telecoms ▲ +4
Cannabis	5	Industrial/Manufacturing ▲ +1

Energy

On the heels of a banner year for deal activity, the energy sector clinched the top spot in terms of 2024 deal volume expectations in this year's rankings. As the global energy transition ramps up—and geopolitical tensions underscore the importance of domestic energy production—it's no surprise that dealmakers see lucrative opportunities in this industry sector. Roughly half of dealmakers cite high commodity/energy prices, infrastructure financing provided by the Inflation Reduction Act, and the need for traditional energy infrastructure as the top drivers of M&A in the energy sector.

Respondents' views were likely informed by the sheer number of high-value investments in energy companies during 2023. The Inflation Reduction Act has spurred more than $110 billion in new clean energy manufacturing investments, and clean energy investments are expected to hit $2 trillion by 2030. Moreover, energy and commodity prices are projected to remain at historic highs over the next two years, while demand for traditional energy infrastructure, including pipelines and storage, has yet to wane.

Financial Services

Dealmakers expect innovation in financial services to drive significant M&A activity over the next 12 months. Over half say the rise of fintech and innovative banking products—as well as investments in tech, automation, and AI applied to financial services—will fuel deals. These innovations continue to unlock new efficiencies for big banks and lenders on Wall Street. In addition, AI startups are attracting significant investment interest from U.S. financial giants. Moreover, analysts expect further consolidation in financial services in response to this year's regional bank collapses.

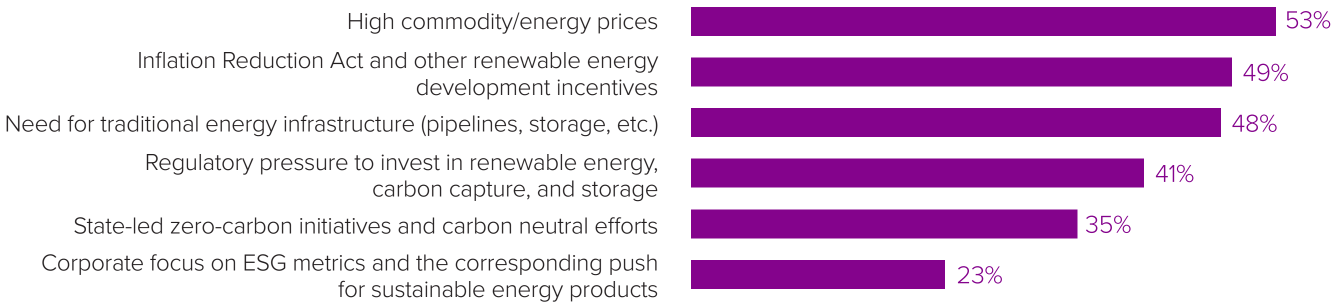
Healthcare

Healthcare moved up to third place this year, despite M&A activity in that sector reaching a three-year low in the second quarter of 2023. But dealmakers expect alternative care models and medtech—both centered around digital health technologies—to boost dealmaking. Further, 38% of dealmakers anticipate emerging AI solutions and platforms will also fuel M&A activity in the healthcare sector. This outlook could be driven by the number of startups in the AI space promising to slash administrative expenses in the healthcare sector, where they currently make up 30% of all U.S. healthcare costs.

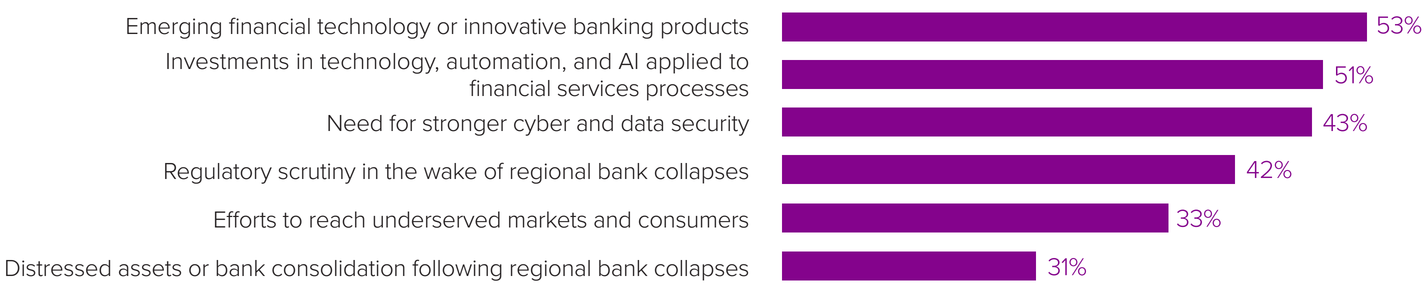
Onshoring

Lastly, 48% of respondents believe onshoring efforts to domesticate global supply chains have increased M&A activity in their respective sectors, while 40% say they have experienced no notable impact. This finding may reflect that the streamlining of supply chains has had a greater impact on some industries—particularly automotive and manufacturing.

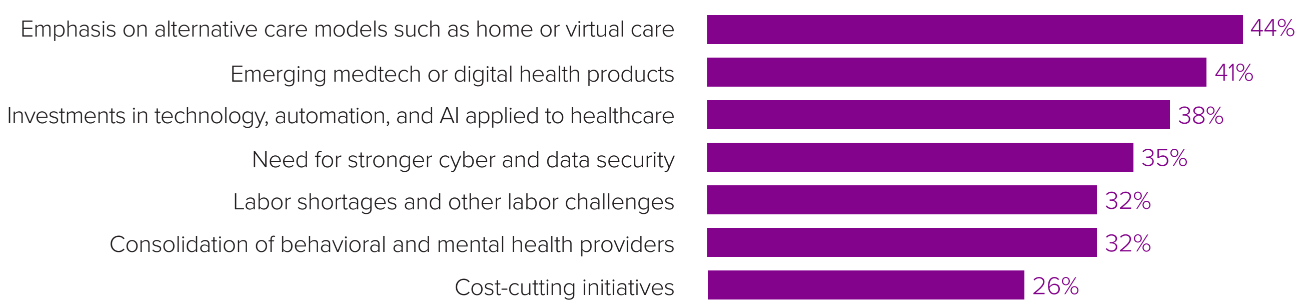
Which of the following trends do you believe will drive activity in the ENERGY sector?



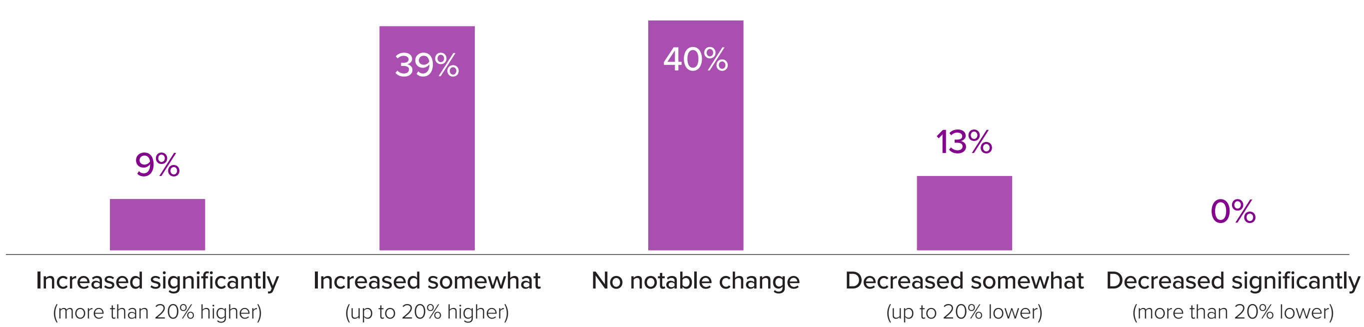
Which of the following trends do you believe will drive activity in the FINANCIAL SERVICES sector?



Which of the following trends do you believe will drive activity in the HEALTHCARE sector?



How has the onshoring movement to shorten global supply chains impacted the volume of M&A opportunities over the past 12 months?



Methodology

In August 2023, 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 263 survey respondents represent a cross section of executives and M&A advisors engaged in more than a dozen sectors, including financial services, technology, media, telecoms, healthcare, industrial/manufacturing, retail, energy, real estate and construction, consumer products, education, logistics, automotive, law, insurance, food and beverage, life sciences, staffing, and cannabis. 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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