Mergers & Acquisitions Outlook Survey 2018/2019
In our 14th annual survey, we polled senior executives 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 the insights they shared for this report.
ECONOMIC OPTIMISM FUELS A VIGOROUS M&A MARKET

Optimism is soaring to the highest levels in the 14-year history of Dykema’s annual M&A Outlook Survey. The portion of respondents who believe that the M&A market will strengthen in the next 12 months jumped to 65 percent from the mid to high 30s, where it stood over the previous several years. Negative sentiment, which had held steady at about 20 percent in recent years, dropped to 15 percent.

This year’s survey is the first since the passage of the Tax Cuts and Jobs Act of 2017. It also comes a decade after the fall of Lehman Brothers, and just before midterm elections in the United States. And the backdrop is rounded out with equity markets that have shrugged off global trade tensions to reach new heights.

The overwhelmingly positive M&A outlook is likely influenced by solid economic fundamentals. In fact, optimism about the economy also set a new high in this year’s survey, with 64 percent reporting a positive outlook. The bullish M&A outlook may also have been fueled by the recent completion of several high-profile megadeals, including Bayer’s $63 billion acquisition of Monsanto.

Despite the euphoria, it’s worth wondering whether the markets will remain strong as we move into the next decade. Given that the current expansion is over nine years old—the second-longest since World War II—many investors are beginning to ask when the next downturn may arrive.

Nearly two-thirds of respondents expect the M&A market to strengthen in the next 12 months, compared to fewer than two in five respondents in each of the past three years. Only 15 percent foresee weakening markets, compared to 20 percent last year.
THE YEAR AHEAD: SMALLER DEALS AND NEW SECTORS DRIVE ACTIVITY

While respondents expect growth across the M&A landscape, they are more bullish about deals below $100 million. This is the third year running that respondents see expansion, or at least stability, in this valuation range. Respondents are less optimistic about larger deals. Only 26 percent expect growth for those over $100 million, while 41 percent said deal volume would diminish.

In one of the survey’s more surprising findings, a new set of sectors is expected to lead the pack when it comes to deals in the year ahead, with automotive jumping to the top of the activity outlook. Dealmaking could be vigorous amid innovation, business model disruption and the rise of new entrants. Consumer products—under pressure from ecommerce giants and potentially taking a hit from tariffs—also rose this year, from fourth to third place, bumping energy up to second place.

Meanwhile, health care and technology, which had occupied the first and second places since 2014, fell to fourth and fifth, respectively, signaling a possible moment of consolidation for these industries after vigorous M&A activity.

Survey respondents are deeply involved in M&A transactions, even more so than last year. Seventy-five percent of respondents said they expect to be involved in an acquisition in the next 12 months, up from 68 percent in 2017. Those who expect to be involved in a joint venture jumped to 56 percent from 38 percent in 2017, and 56 percent expect to be involved in a sale, up from 47 percent.
#METOO MEETS M&A

The survey included several new questions this year. For the first time, we asked about “Weinstein Misconduct Clauses.” In the wake of sexual harassment scandals involving Harvey Weinstein and other high-profile executives, such clauses legally vouch for the behavior of the company’s leaders.

Only 28 percent of respondents have been involved in a deal where such a clause has been proposed, suggesting that the #MeToo movement may not have yet reached middle-market M&A to a substantial degree. Of the respondents that had been involved in a deal with a Weinstein clause, nearly nine out of 10 featured a knowledge qualifier, making sellers liable only if they fail to disclose known misconduct.

REPRESENTATIONS AND WARRANTIES INSURANCE

We also asked about representations and warranties insurance. These policies protect the insured against unintentional breaches of a seller’s representations and warranties in an M&A deal. They are increasingly important and are growing more common now that a competitive marketplace for policies has led to improved terms.

Overall, nearly 60 percent of respondents said representations and warranties insurance had been used in deals they worked on over the past 12 months. Use of such policies was more common in some industries, including financial services (64 percent), manufacturing (64 percent) and tech (68 percent). Nearly half of respondents said the cost of the policies was split between buyers and sellers, while a third reported that policy premiums were paid for by buyers.
ARTIFICIAL INTELLIGENCE FOR DUE DILIGENCE

This year we also started asking about whether respondents were using artificial intelligence for due diligence. The technology can be used, for example, in reviewing large numbers of contracts to find certain terms. Despite increased discussion on the topic, only 28 percent have used the technology for this purpose.

Respondents report several different uses of AI, including “word searching on various databases,” “forecasting future economic situations” and “using data analytics to evaluate customer activity and pricing.”

Have you used artificial intelligence solutions in conducting due diligence?

- 28% YES
- 66% NO
- 7% UNSURE
M&A DRIVERS AND OBSTACLES

For the fifth year, availability of capital was expected to be the leading driver of M&A activity, but this year its dominance diminished. Only 33 percent of respondents chose it as the strongest M&A driver, compared to 55 percent in 2017. A similar number, 31 percent, chose general U.S. economic conditions as fueling M&A, followed by favorable interest rates, financial markets and changes in U.S. tax laws, each with 11 percent. The biggest obstacles to M&A are availability of quality targets, buyer competition and valuation. These are the same top obstacles as in 2017, although this year buyer competition eclipsed valuation to become the second-biggest obstacle.

A greater portion of respondents ranked availability of quality targets high, suggesting that it is an escalating impediment. This, along with elevated concern over buyer competition, points to very large numbers of capital chasing deals (see The Rise of High-Flying Financials on the next page for more on this). Anecdotally, market participants indicated that this late in the business cycle, the quality of deals tends to suffer, with rising prices and greater competition among buyers. Due diligence ranked as the fourth-largest obstacle. Respondents encumbered by due diligence indicated that buyers had burdened the process with new levels of detail and that not all market participants were “consistently honest.”

**Leading Drivers of M&A Activity**

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<thead>
<tr>
<th>Factor</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Capital</td>
<td>33%</td>
</tr>
<tr>
<td>U.S. Economic Conditions</td>
<td>31%</td>
</tr>
<tr>
<td>Favorable Interest Rates</td>
<td>11%</td>
</tr>
<tr>
<td>Financial Markets</td>
<td>11%</td>
</tr>
<tr>
<td>Changes in U.S. Tax Laws</td>
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</tr>
</tbody>
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**The Biggest Obstacles to M&A Activity**

- Availability of Quality Targets
- Buyer Competition
- Valuation
THE RISE OF HIGH-FLYING FINANCIALS

For the third consecutive year, respondents have changed their views on whether financial or strategic buyers most influenced deal valuation over the past 12 months. This year, financial buyers ranked first, although strategics were seen as having a greater impact in every year prior to 2016 (see chart). The rising power of financial buyers correlates with the record levels of private equity dry powder. While the conventional wisdom is that strategics can justify higher valuations due to synergies, financials have immense amounts of cash, and competition among buyers for quality targets is so high that valuation is less of a concern.

With the strong economic outlook, financial buyers feel confident about returns even if they pay a higher price for acquisitions, hoping that valuations will continue trending upward. Yet as pressure mounts to put capital to use, deal quality could suffer. As one respondent commented, “There is a large and growing supply of capital that needs to be deployed in an environment where a limited number of opportunities exist.”

Regulatory policy is another possible explanation for the shift from strategics to financials. One respondent suggested that Trump administration policies have made strategic acquisitions less of an imperative: “Multiples have decreased as strategics refocused on internal development versus acquisition. During the Obama years, strategics acquired because they were not comfortable with U.S. regulatory policies, labor laws and health care expenses.” The perceived influence of foreign buyers on valuations also continues to rise, with 17 percent of respondents saying that they had the greatest influence over deal valuation, up 10 percent since 2016.

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

<table>
<thead>
<tr>
<th>Year</th>
<th>Strategic U.S. Buyers</th>
<th>Financial U.S. Buyers</th>
<th>Foreign Buyers</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>44%</td>
<td>30%</td>
<td>16%</td>
</tr>
<tr>
<td>2012</td>
<td>41%</td>
<td>38%</td>
<td>13%</td>
</tr>
<tr>
<td>2013</td>
<td>48%</td>
<td>36%</td>
<td>13%</td>
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<tr>
<td>2014</td>
<td>42%</td>
<td>36%</td>
<td>18%</td>
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<tr>
<td>2015</td>
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<td>2016</td>
<td>49%</td>
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<td>2017</td>
<td>47%</td>
<td>41%</td>
<td>11%</td>
</tr>
<tr>
<td>2018</td>
<td>44%</td>
<td>38%</td>
<td>17%</td>
</tr>
</tbody>
</table>
Overall, bullish expectations on private company M&A rose slightly to 82 percent this year, reaching the level last seen in 2014. Taken together, our findings on private companies suggest that owners are cashing in because the strong economy and vigorous M&A market make divestitures attractive. This contrasts with last year, when the key motive was cashing in for retirement or getting out before the window closed.

In 2017, 44 percent of respondents said the primary factor driving private business sales was the advancing age of the owner, suggesting that baby boomers were shedding family businesses. This year, while that response still topped the list, only 20 percent chose it. In contrast, the number who said that it was a good time to sell because earnings are increasing jumped from 7 percent in 2017 to 20 percent this year.

**Why?**
Aging business owners are seeking to sell.
Current earnings are increasing.

**Why not?**
Current earnings are trending stable.
Owners are uncertain about future life transition plans.
At a time when the nation is divided over politics, respondents appeared to be conflicted about how politics will impact dealmaking. A plurality believes that Democratic victories in Congress would be a favorable outcome for M&A activity. Specifically, 46 percent said a Democratic victory in the House of Representatives would be somewhat or very positive, while only 36 percent said it would be somewhat or very negative; 19 percent were neutral. For the Senate, 48 percent were positive versus 35 percent negative.

There are several possible explanations for this. Respondents may see a need for congressional restraint on the Trump administration, they may believe that gridlock would reduce the potential for regulation or they may value the democratic process.

Despite the support for a change in Congress, the survey found strong support for the Trump administration’s fiscal policy. Most respondents foresee a positive impact on M&A markets from the corporate tax cut (81 percent), U.S. repatriation tax changes (78 percent) and personal income tax decreases (68 percent). Even deficit spending, which has risen under Trump, was seen as supporting M&A by 52 percent of respondents; only 23 percent expected it to hurt deals.

With the U.S. and its trade partners exchanging threats and imposing tariffs during the survey period, respondents were more divided on trade issues. Slightly over half of respondents believe U.S. tariffs would benefit M&A activity, while 44 percent said increased trade barriers would help M&A activity. Only 34 percent expected barriers to be harmful to M&A activity. Just over a third were concerned that retaliatory tariffs from abroad would harm dealmaking, while 44 percent said such tariffs would support M&A activity. This could reflect the idea that trade tensions could compel executives to seek deals to protect profits—a U.S. manufacturer, for instance, may seek local production in China to circumvent tariffs or barriers.

Market participants’ reactions to policy challenges changed dramatically from last year, when the most common response was to delay a transaction when faced with concerns over antitrust enforcement, corporate tax reform or financial institution regulatory reform. This year, market participants were far more likely to act. Brexit is a strong example of this. Among respondents influenced by Brexit, 41 percent reported a sale, versus 7 percent last year, suggesting a strong negative impact on many executives’ outlooks.

46 percent of respondents said a change from a Republican to a Democratic majority in the U.S. House of Representatives in the upcoming midterm elections would be somewhat or very positive, while only 36 percent said it would be somewhat or very negative; 19 percent were neutral.

For the Senate, 48 percent of respondents said a change from a Republican to a Democratic majority would be positive versus 35 percent negative; 17 percent were neutral.
Methodology

In September 2018, 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. The respondents to the survey represent a cross-section of M&A professionals and advisers with a diverse group of professions and more than a dozen sectors represented, including automotive, health care, technology, industrial/manufacturing and financial services. Respondents represent companies whose annual revenues range from under $1 million to more than $1 billion.