M&A

16TH ANNUAL MERGERS & ACQUISITIONS OUTLOOK SURVEY

Dykema

16th Annual
Mergers & Acquisitions
Outlook Survey

Dykema

In our 16th annual survey, we polled senior executives and professional advisers across the nation—CEOs, CFOs, owners, managing directors and other professionals who engage in M&A-related activity at 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.

Cautious Optimism for an M&A Rebound in 2021

When we surveyed M&A professionals in the fall of 2019, only a third were bullish about deal-making in the coming year—and that was well before anyone knew a global pandemic would bring the U.S. economy to a virtual halt in the coming spring. Polling deal-makers again in June of 2020, three months into COVID-19 lockdown measures, we found that half were optimistic about the next 12 months.

Four months later, even in the face of continued COVID-19 uncertainty and a tumultuous presidential election, deal-makers see better days ahead: 71 percent of respondents to Dykema's 16th annual M&A Outlook Survey say they are bullish about U.S. deal-making over the next 12 months, 87 percent expect M&A activity involving privately owned businesses to increase over the same time frame and 72 percent say their company (or one of their portfolio companies) will be involved in an acquisition in the next year.

We believe the rise in optimism reflects deal-makers' feelings that the worst is behind them. It also reflects actual market conditions: Deal activity has picked up noticeably in the months since U.S. states began reopening for business. Both financial and strategic buyers see opportunities in a hobbled economy, and with significant uncertainty ahead, business owners may view this as an opportune time to cash out.

There is no single factor driving the strong positive outlook for private-company M&A. Among the top reasons: aging business owners seeking to sell and uncertainty surrounding COVID-19 and the economy. Respondents also say rising earnings could fuel M&A—a positive sign for businesses that are growing as a result of the new normal.

When looking shorter term, it is not surprising a majority of respondents (59 percent) believe the second half of 2020 will be worse than the latter half of 2019. They likely recognize that a stable U.S. economy is typically the greatest driver of M&A activity, and given the beating the economy has taken in 2020, some short-term pessimism appears sensible. However, a significant minority (33 percent) of respondents expect the second half of 2020 to produce a stronger M&A market than the same period last year.

Importantly, 60 percent of respondents say their outlook for the U.S. economy is positive over the next 12 months. That's a significant jump from our Flash Survey in June, when only 34 percent expressed optimism about the year ahead, and from our Automotive Survey in July, in which just 18 percent of auto executives were positive about the next 12 months. By late summer, it appears, deal-makers had begun to see clearer skies on the horizon.

Short-Term Caution, Medium-Term Optimism

How will the U.S. M&A market over the second half of 2020 compare to the second half of 2019?

27%
Second half of 2020 will be significantly worse than the second half of 2019

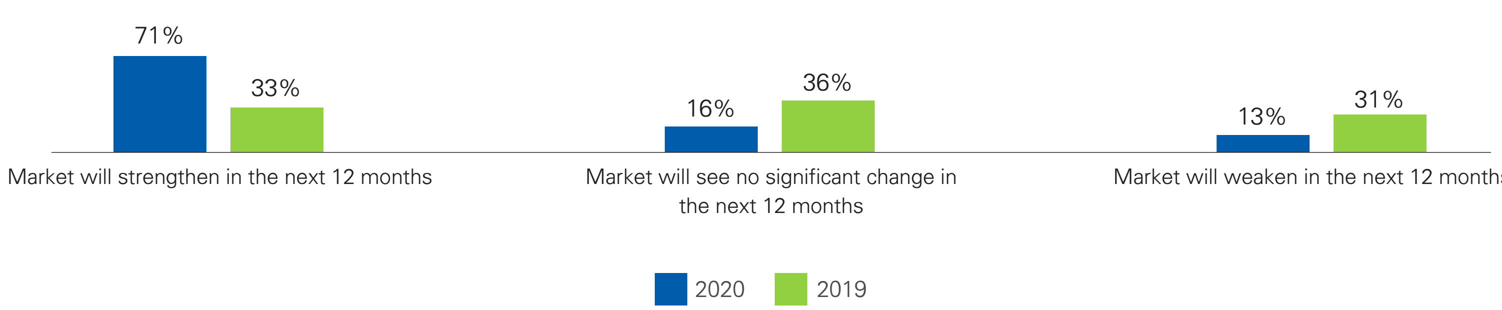
32%
Second half of 2020 will be somewhat worse than the second half of 2019

8%
There will be no significant difference

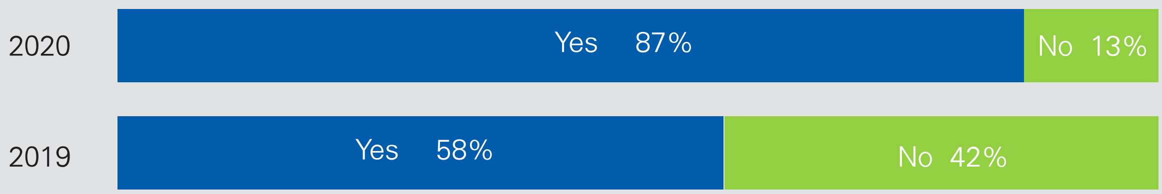
26%
Second half of 2020 will be somewhat better than the second half of 2019

7%
Second half of 2020 will be significantly better than the second half of 2019

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



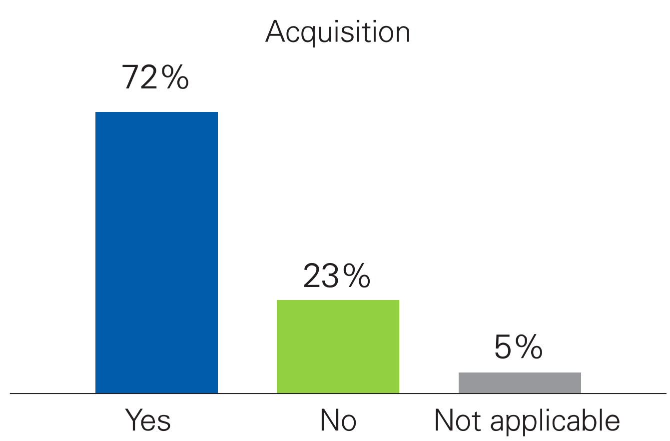
Do you expect there to be an increase in M&A activity involving privately owned businesses in the next 12 months?



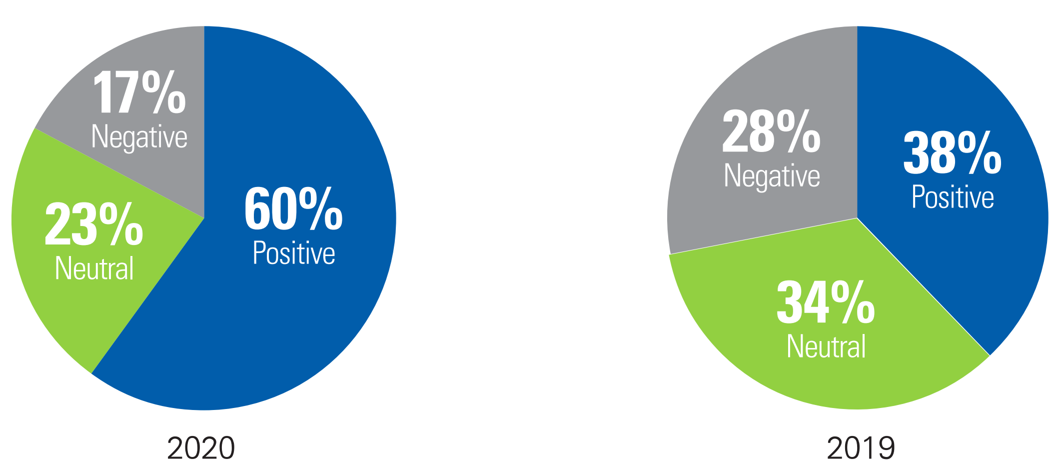
Why?

- **15%** Concerns/uncertainties surrounding COVID-19
- **15%** Concerns/uncertainties surrounding the economy
- **14%** Current earnings are increasing
- **13%** Aging business owners seeking to sell
- **12%** Improving valuations
- **10%** Capitalizing on valuations impacted by COVID-19
- **10%** Current earnings are stable
- **5%** Concerns about declining valuations
- **4%** Current earnings are decreasing

In the next 12 months, do you believe your company, or one of your portfolio companies, will be involved in an acquisition?



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



As the effects of COVID-19 continue to batter the U.S. economy, the majority of respondents say the second half of this year will be worse than the same period in 2019. Looking 12 months out, however, 71 percent of respondents believe the market will strengthen and a full 87 percent expect deal activity involving privately owned businesses to increase—both marked increases from last year.

Domestic Concerns Move to the Forefront

Even as the outlook for the next 12 months brightens, significant threats loom—many of which weren't on deal-makers' radars this time last year. In our 2019 survey, respondents saw trade tensions with China as the greatest threat to M&A activity, a concern that has taken a back seat to a handful of domestic challenges respondents consider more ominous.

Atop the list: COVID-19. Nearly two-thirds (63 percent) of respondents rank it among the three greatest threats to deal activity in the coming year. (More on the pandemic's impact on deal-making below.) The outcome of November's election is also expected to have a significant impact, according to the survey. Nearly half of respondents (48 percent) believe the election of Joe Biden, the Democratic nominee, poses the biggest threat to M&A in the next year, while 46 percent consider Democratic control of Congress to be the greatest threat. (More on respondents' views of the political landscape below.)

Each of our respondents' top six concerns revolves around domestic issues. This year only 21 percent of survey participants have Chinese trade tensions in their top three threats to deal-making, down from 43 percent last year. Meanwhile, 29 percent of this year's respondents list increasing protectionism and political intervention as a top threat, up from just 8 percent last year.

Two cross-border challenges have garnered the attention of deal-makers this year. Increased scrutiny and delay in approvals of cross-border deals by regulators and national opposition to major deals in attempts to ensure fair competition both jumped significantly among respondents' concerns in 2020. The increased concerns reflect both the heightened scrutiny the Trump administration has applied to inbound foreign investment in the U.S.—a trend that began shortly after Donald Trump took office in 2017—and the administration's recent high-profile intervention in deals involving the Chinese-owned mobile app TikTok.

COVID-19 Tops List of Threats to M&A

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

Because multiple answers per participant are possible, the total percentage exceeds 100%.

	2020	2019
Continued spread of COVID-19	63%	
Joe Biden wins presidential election	48%	
Democrats take control of House and Senate	46%	
Donald Trump wins re-election	31%	
Increasing protectionism and political intervention	29%	8%
Republicans take control of House and Senate	23%	
China trade tensions	21%	43%
Increased scrutiny and delay in approvals of cross-border deals by regulatory bodies	19%	3%
National opposition to major deals in attempts to ensure fair market competition	18%	8%
U.S. political uncertainty		35%
Enhanced scrutiny of big technology companies		2%
Passage of USMCA		1%

COVID-19's Continuing Impact on Deal-Making

M&A activity did not escape the economic havoc wreaked on the U.S. economy by COVID-19 in early 2020. In our Flash Survey, more than 90 percent of respondents reported some type of disruption caused by the pandemic. More than a third (35 percent) said they had terminated negotiations. Fifty-eight percent said COVID-19 had delayed negotiations, 37 percent said it had delayed a transaction's closing and 33 percent said it had reduced a transaction's valuation. Less than 4 percent said it had increased deal-making activity.

Four months later, respondents to our annual survey say the most common obstacle related to COVID-19 is the availability of quality acquisition targets. The dearth of targets ranks even above economic uncertainty as an obstacle. Financing ranks third, likely reflecting the reluctance of lenders to fund transactions in the midst of a pandemic-induced recession.

Perhaps surprisingly given our Flash Survey findings, respondents to the annual survey rank due diligence fairly low (sixth) on the list of obstacles—48 percent of Flash Survey respondents said COVID-19 had impacted due diligence back in June. Clearly, deal-makers found a way to perform due diligence and keep transactions moving even under lockdown conditions that prevented some standard practices, such as site inspections.

Even so, respondents clearly don't believe M&A activity is in the clear. Looking ahead, 54 percent say they expect COVID-19 to have at least a somewhat negative impact on the M&A market in the next 12 months. Twenty-eight percent, on the other hand, expect the pandemic to have a positive impact; those respondents may represent deal-makers in sectors like health care where the impact of the shutdown has created pockets of consolidation (such as small and midsize providers that struggled to survive temporary state-level bans on non-urgent medical procedures) or deal-makers looking to acquire distressed businesses.

Survey respondents by and large took advantage of government programs aimed at helping businesses survive COVID-19 restrictions and their fallout. The Paycheck Protection Program (PPP), aimed at helping employers weather the crisis without layoffs, proved most popular—73 percent of respondents say a target company in one of their deals accepted that loan.

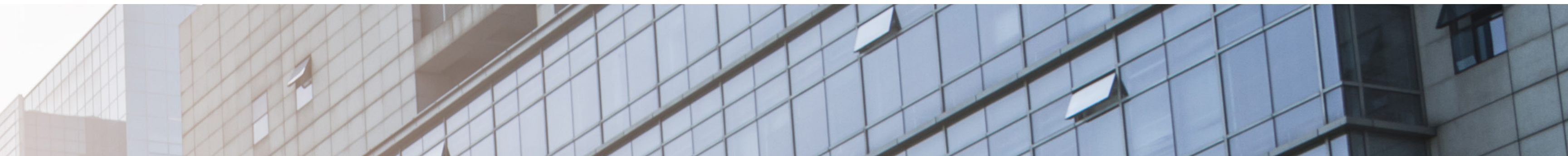
The ubiquity of PPP loans meant they regularly came into play in the transactions that moved forward in 2020. However, here again, deal-makers for the most part found ways to navigate this potential complication. Only 8 percent of respondents who worked on deals involving PPP loans report a failed closing due to the loans. No predominant method for managing the loans emerged, but the most common scenario was to require the seller to maintain an escrow account until the loans were forgiven. This is likely to become even more common given recent moves by the Small Business Administration (SBA). Since we conducted our survey, the SBA issued a procedural notice that permits PPP lenders to approve a change in control of a PPP borrower, without SBA approval, if the parties set up an escrow account controlled by the lender with funds equal to the principal amount of the loan.

Additionally, buyers clearly were unwilling to bear the risk associated with PPP loans—only 16 percent of respondents say buyers assumed the loans. The message to potential sellers: Prepare to address buyers' low risk tolerance for PPP loans before seeking a buyer. If possible, apply for PPP forgiveness and try to accelerate the timing of your loan forgiveness.

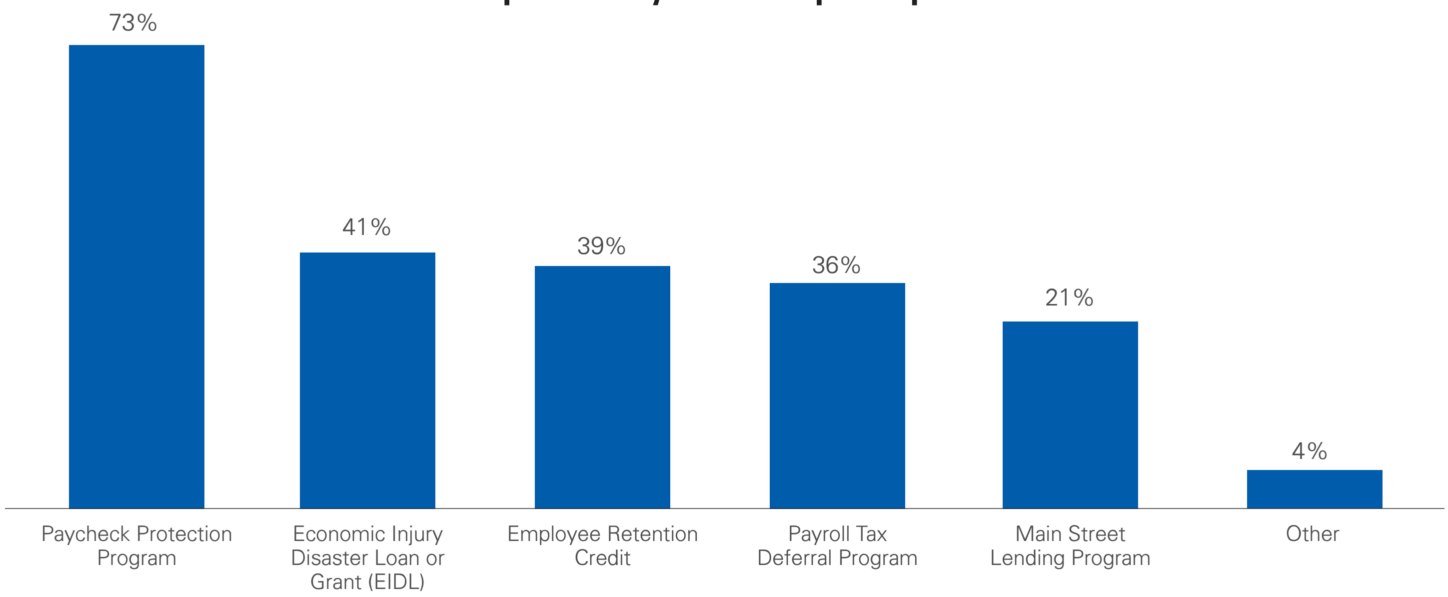
Deal-Makers See Further COVID-19 Fallout Ahead

What type of impact do you expect the COVID-19 pandemic to have on the U.S. M&A market over the next 12 months?

16%	38%	18%	19%	9%
Significant negative impact	Somewhat negative impact	No notable impact	Somewhat positive impact	Significant positive impact



In which of the following CARES Act programs have target companies in your deals participated?



Because multiple answers per participant are possible, the total percentage exceeds 100%.

How have outstanding Paycheck Protection Program (PPP) loans been dealt with in M&A deals in which you have been involved?

- **38%** Buyer required escrow in the amount of PPP loan, until forgiven
- **32%** Reduced purchase price by amount of PPP loan
- **30%** PPP lender required escrow in the amount of PPP loan, until forgiven
- **28%** Treated forgivable amount as debt
- **19%** Required seller to pay off PPP loan at closing
- **17%** Did not treat forgivable amount as debt
- **16%** Buyer assumed PPP loan
- **8%** Deal did not close because of PPP loan
- **7%** Other

Because multiple answers per participant are possible, the total percentage exceeds 100%.

Understanding COVID-19 likely has directly or indirectly impacted some of the following, what are the three most common obstacles you have experienced in deals in the past 12 months?

2019		2020
Availability of quality targets	1	Availability of quality targets
Buyer competition	2	Economic uncertainty
Valuation	3	Financing
Financing	4	Buyer competition
Tariffs	5	Valuation

The 2020 Election: High Stakes for M&A

Respondents see a sharp divide in potential ramifications from the November 3 election. Nearly twice as many deal-makers believe Donald Trump's re-election would be positive for M&A (61 percent) compared to a Joe Biden victory (34 percent).

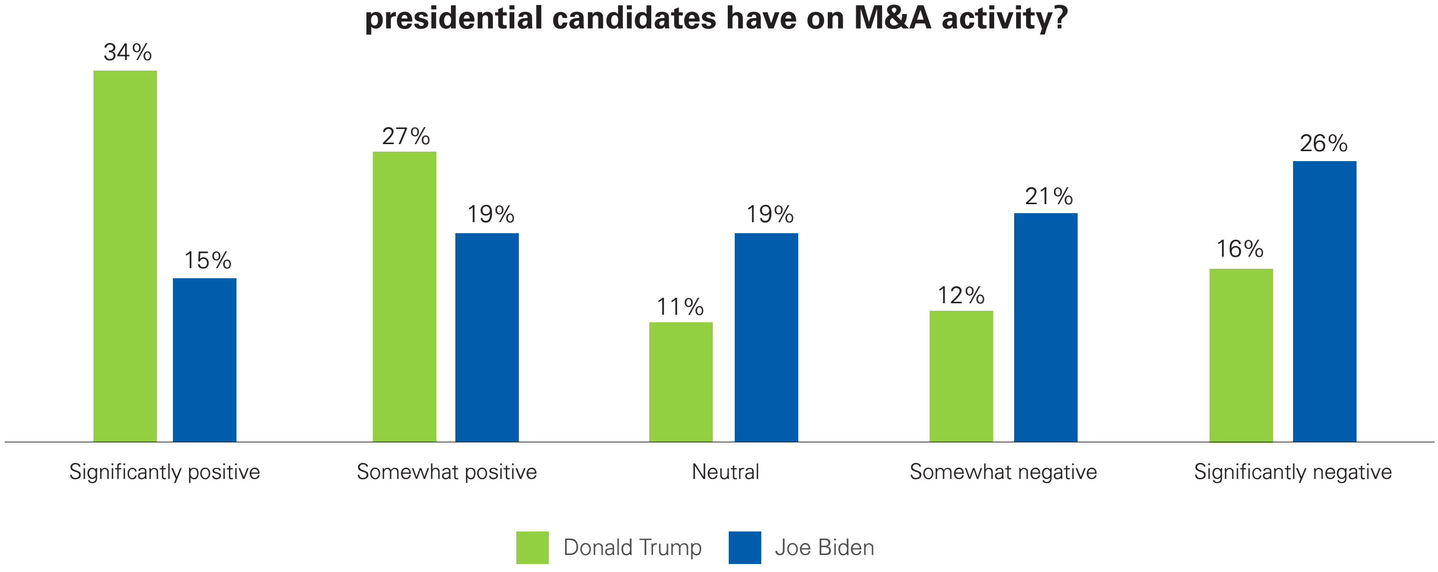
That represents a greater imbalance than in the last presidential election. In our 2016 survey, only 28 percent of respondents said Donald Trump's election would be positive for the M&A market, while 19 percent said a Hillary Clinton presidency would be. Back in 2016 our respondents simply didn't know what to expect from Trump; four years later the administration's policies and actions seem to have more deal-makers hoping for four more years of the continuation of policies they view as positive for M&A, principally tax policies.

Forty-seven percent of respondents believe a Joe Biden presidency would be bad for M&A, compared to 32 percent who believed the same about Hillary Clinton—indicating the market views Biden as less business-friendly than Clinton would have been. Biden has proposed increasing the corporate tax from 21 percent to 28 percent and voiced support for increasing capital gains taxes, either of which could be a drag on M&A activity.

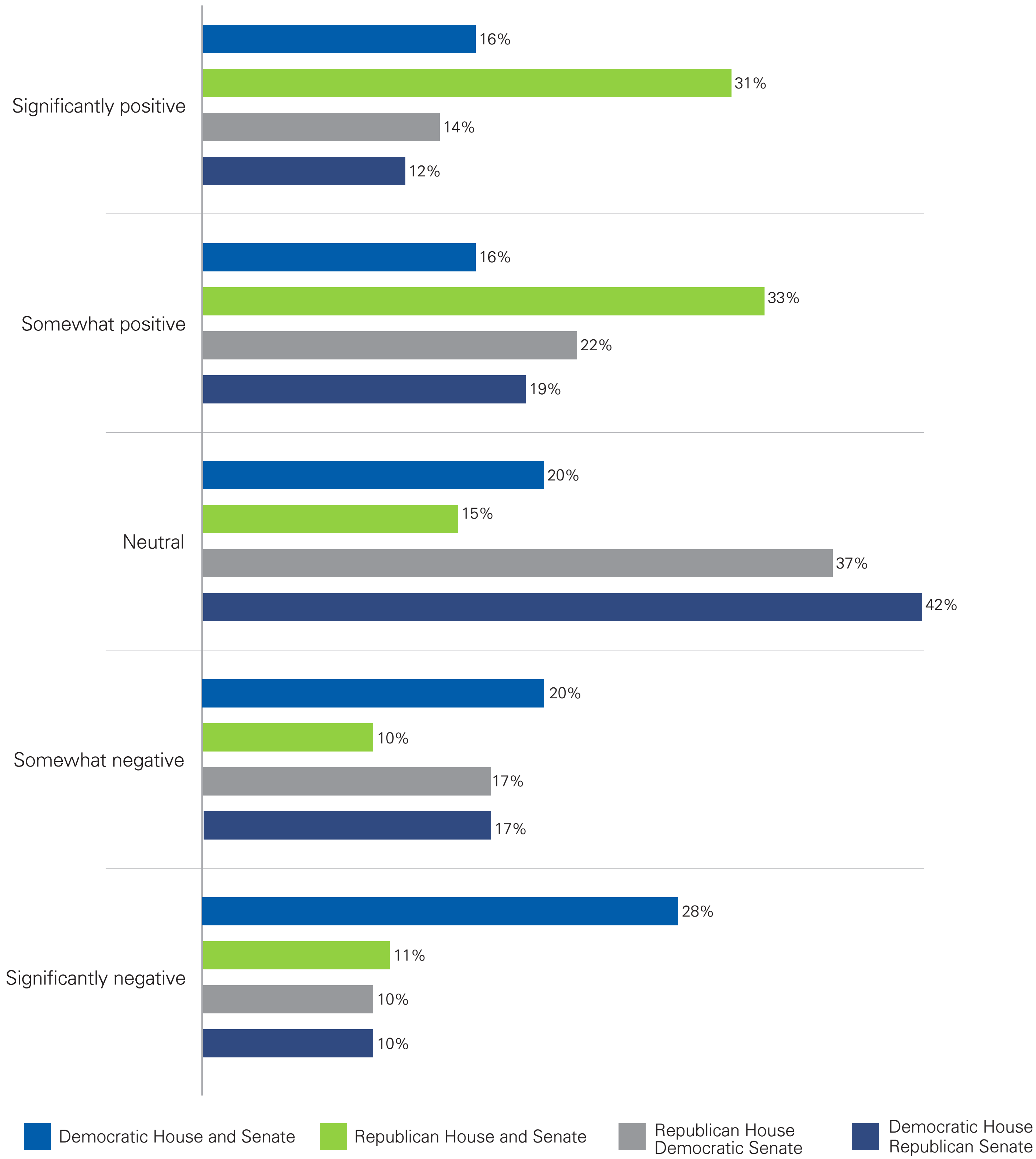
There is real concern among deal-makers this year around questions of congressional control. Respondents see Republican control of both houses of Congress as the most favorable outcome for M&A—64 percent see that as a positive configuration. Half as many (32 percent) view Democratic control of both houses as positive for M&A. No surprise here: A Democratic Congress might be emboldened to enact new restrictions on business such as the Stop Wall Street Looting Act—introduced by Senator Elizabeth Warren in July 2019, it would close the carried interest loophole and impose other new restrictions on private equity.

Thirty-six percent view a Republican-controlled House and Democratic-controlled Senate as positive for M&A, while 37 percent view that configuration as having no impact on M&A. Thirty-one percent see the opposite split configuration as positive, with 42 percent viewing it as having no impact on deal-making. This comes as no surprise: Business leaders often view split control as a positive—it means nothing gets done, including new regulation. In our 2018 survey, respondents said Democratic victories in both the House and Senate would be positive—perhaps in hopes that a Democratic Congress would fight President Trump to a stalemate.

What impact would the election of the following 2020 presidential candidates have on M&A activity?



What impact would the following congressional configurations have on M&A activity?



Automotive, Health Care Remain Strong

Once again, survey respondents selected automotive as the sector most likely to see the highest level of M&A activity in the next 12 months. Automotive was chosen by a wide margin over the sector coming in second—health care. The top two sectors remain the same as in our 2019 survey. But technology jumped from our previous survey, where it ranked fifth, while the energy sector dropped from third on the list in 2019 to eighth.

The expectation for an active automotive sector likely revolves around the assumption that the industry will continue to undergo unprecedented change and automakers will continue to acquire technology for new vehicles, especially as they work to develop autonomous vehicles and electric vehicles. The response is somewhat surprising given that in our survey of automotive executives in July, only 34 percent expressed a positive outlook for M&A in their industry. But even fewer (30 percent) had a negative outlook, and 36 percent characterized their outlook as neutral; perhaps continued economic improvement has given rise to increasing optimism about the sector.

Similarly, respondents likely expect a flurry of technology deals in the health care sector as provider organizations seek new tools for treating and interacting with patients in a COVID-19, and post-COVID-19, environment.

Automotive, Health Care Remain on Top

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

2019		2020
Automotive	1	Automotive
Health care	2	Health care
Energy	3	Technology
Consumer products	4	Consumer products
Technology	5	Financial services

Strategic Buyers Resurgent

For much of 2020, strategic foreign buyers were practically shut out of the U.S. market. A combination of COVID-19-related restrictions and, in many cases, business challenges of their own made it extremely challenging to pursue domestic acquisition targets.

As a result, respondents have seen a dramatic drop in strategic foreign buyers' influence on U.S. deal valuations in the past year. Rushing in to fill that void: strategic U.S. buyers—42 percent of respondents say those buyers influenced deal valuation in the past year, up from 27 percent in 2019.

Strategic U.S. buyers' resurgence puts them atop our list of most influential buyers for the first time since our 2017 survey, likely a reflection of our unique economic conditions. In typical recessionary conditions, private equity and other financial buyers increase their activity, feeding on lower valuations. But amid the swirling uncertainty stirred up by COVID-19, many private equity funds have hit the brakes on acquisitions, turning their attention instead to helping their portfolio companies stay afloat.

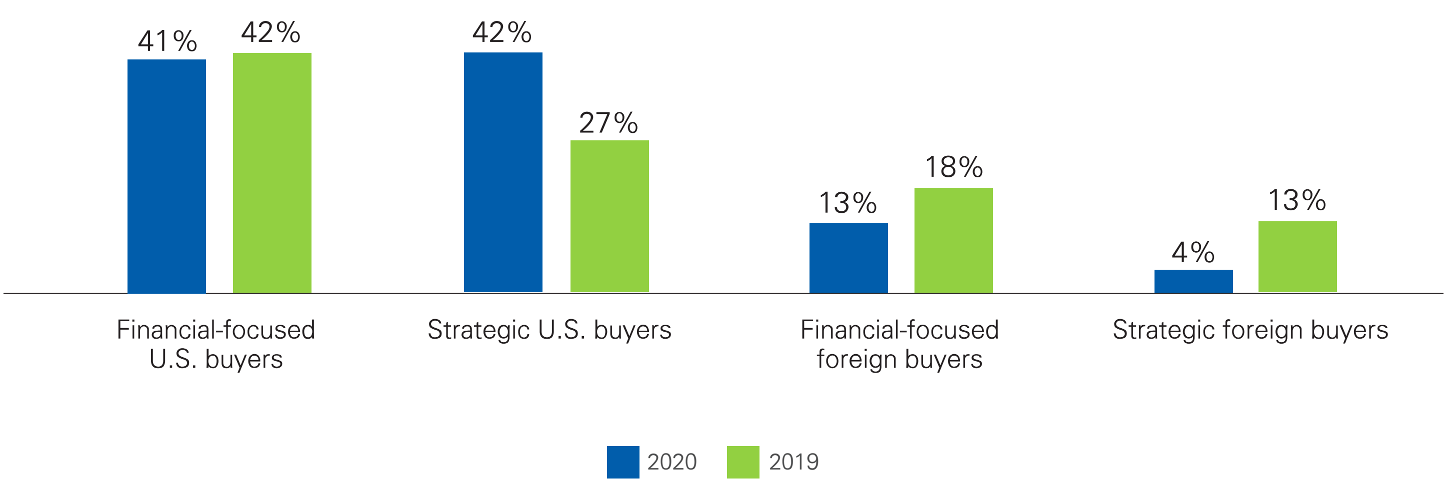
Still, private equity funds are sitting on record amounts of capital. At some point in the near future, these funds will have to turn their attention to deploying all that capital.

Financial-focused foreign buyers' influence dropped as well, according to respondents—perhaps due to the difficulties imposed on foreign investors by the combination of COVID-19 and intensifying scrutiny from the Trump administration.

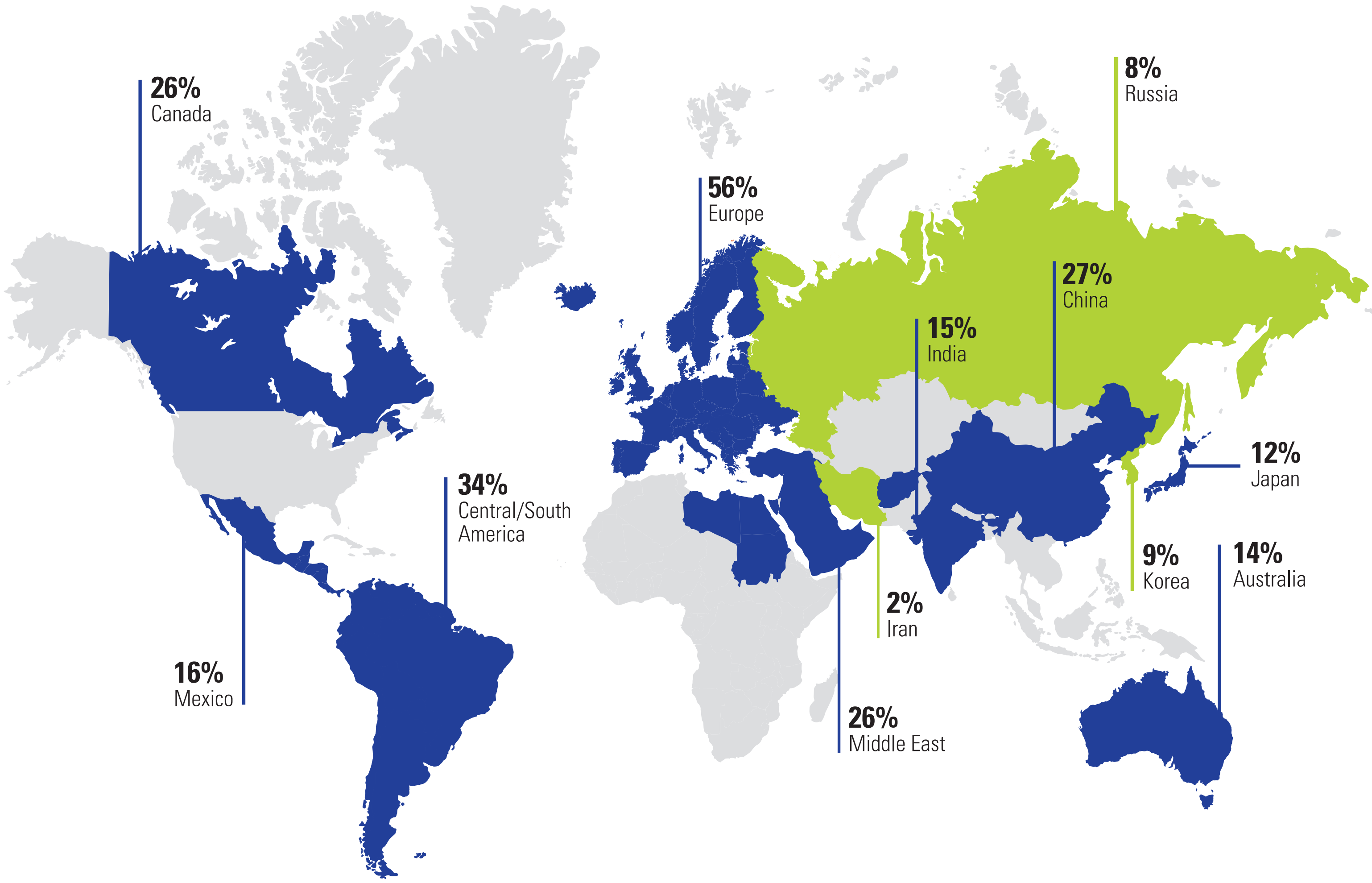
Respondents believe foreign buyers will most likely come to the U.S. from Europe and less from China as compared to last year, likely because concerns about U.S. protectionism are top of mind. Similarly, respondents believe American companies looking outside our borders are more likely to target Europe than China than in 2019, when retaliatory tariffs were top of mind.

Strategic U.S. Buyers Surge

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



Which regions will experience an increase in inbound U.S. M&A activity in the next 12 months?



Because multiple answers per participant are possible, the total percentage exceeds 100%.

Which regions will experience an increase in outbound U.S. M&A activity in the next 12 months?

46% Europe

29% China

28% Central/South America

26% Canada

16% Australia

16% Middle East

14% Japan

14% Mexico

12% India

8% Korea

5% Iran

3% Russia

2% Other

Because multiple answers per participant are possible, the total percentage exceeds 100%.

Dykema

Exceptional service. Dykema delivers.

Methodology

In September and October 2020, 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 advisers engaged in the M&A industry. The 225 survey respondents represent a cross section of executives and M&A advisers engaged in 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. Respondents to this year's survey were located in 39 states across the United States. Due to rounding, percentages used in some questions may not add up to 100 percent.