May 16, 2024

What's the deal with the M&A market?

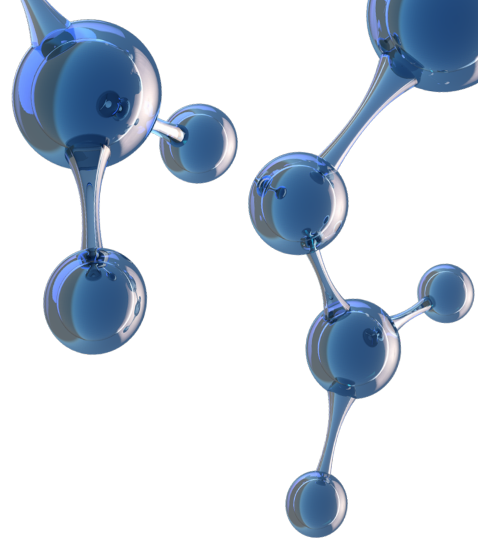
If momentum in the mergers and acquisitions (M&A) space is building—and it is—the market itself seems to be undergoing some turbulence.[1] The improving values reflect not only renewed dealmaking but also, beneath the surface, some reinvention of select, longstanding practices.

A bit of context: The record-setting M&A activity of 2021 started running out of steam in mid-2022.[2] By the end of 2023, M&A deals had plunged to their lowest level in a decade. The decline in private equity-sponsored deals, which typically comprise about 30% of global M&A activity, was especially steep.[3] But the market started to recover in the fourth quarter of last year, propelled by a pair of mega deals—valued at more than $50 billion apiece—in the oil and gas sector.[4] Perhaps driven by a sense that interest rates had topped out, the uptick continued into the first quarter of this year, when US M&A aggregate dollar value rose 59% to $431.8 billion.[5]

But the headwinds that initially drove many dealmakers to retreat haven't dissipated. By now, the list is familiar: geopolitical tensions, high debt-financing costs fueled by a bumpy descent in inflation, tougher regulatory oversight, and the yet-to-be-determined impact of AI. The valuation gap between buyers and sellers, partially sustained by soaring equity markets, has yet to be fully bridged. And the Federal Reserve's much-anticipated plan to cut interest-rates later this year has grown less certain.[6]

Given those less-than-ideal conditions, today's resurgent M&A market reflects creative problem-solving that grew out of the two-year lull. Deloitte's 2024 M&A Trends Survey: Mind the gap[7] finds that the improving numbers reflect a series of innovative approaches in areas like financing, deal structure, and knowledge-sharing.[8] Both corporations and private equity (PE) firms have invested in internal transformations, potentially streamlining such arduous steps in the M&A process as target identification and due diligence (for more on finance transformation in PE, see " New asset class? Why PE firms should consider investing in their own finance departments," *CFO Insights*, July 13, 2023). The survey drew responses from 1,500 executives, divided almost equally between corporations and PE firms. Nearly all respondents (99%) agreed that their organizations have begun using advanced data analytics or generative AI (GenAI) to enhance M&A lifecycle tasks.

In this edition of *CFO Insights*, we'll examine how the sharp swings and successive challenges in recent years have led to a retooling of the M&A market. We'll also explain why dealmakers from both corporations and financial sponsors appear to be regaining confidence in using M&A to achieve their strategic or investment objectives.



Running backlog

The 2024 M&A Trends Survey surfaced a high level of optimism among executives, with more than 90% expecting an M&A rebound this year, fueled by deals rising in both volume and value. Overall, 83% of respondents said they expected the average number of transactions their companies will close over the next 12 months to increase. Similarly, 82% expect the value of their organization's deals to grow larger.

CFOs, on the other hand, appear to be less bullish in their expectations for M&A deals. In a separate Deloitte inquiry, the 4Q 2023 *CFO Signals™* survey, 46% of 124 CFOs said they expected their company's average number of deals to stay the same over the next 12 months. Thirty-four percent of the surveyed finance chiefs expect that number to increase (see Figure 1).

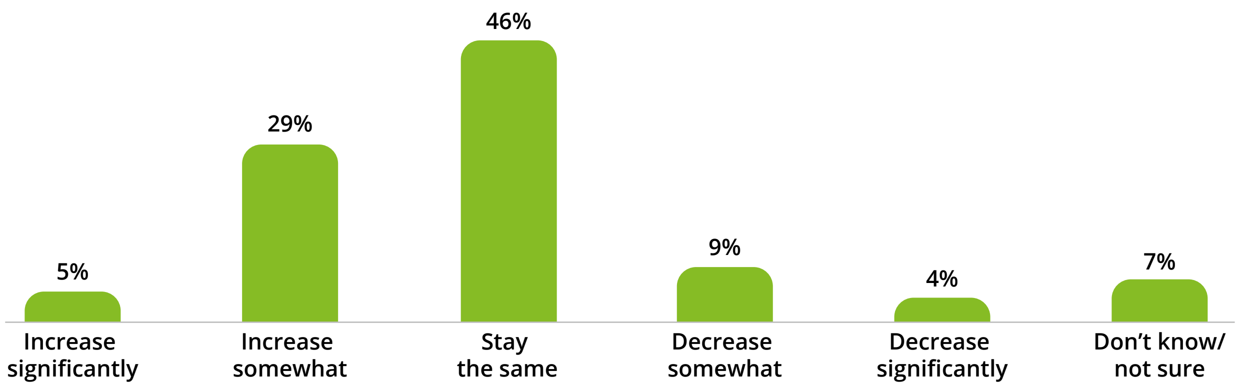
Some macroeconomic factors that shape dealmaking, such as inflation and interest rates, appear to be stabilizing. Beyond that, renewed interest in M&A is partly being fueled by pent-up demand.[9] Many PE firms are itching to monetize their aging portfolio companies. With more than $2.5 trillion of dry powder stashed on the sidelines[10]—capital that is committed, but unallocated—their limited partners might be termed, at times, as impatient investors. And as the post-pandemic economy emerges, some private equity firms and corporations have committed to adapting and transforming their business models. M&A can play a pivotal role in making such transformations.

On another front: the comparative, and growing, strength of the US dollar[11] may make cross-border transactions more appealing, giving companies with sturdy balance sheets more purchasing power. Corporate and PE interest in international targeting to find value has increased 22 percentage points in the past two years (68% in 2021 vs. 90% in 2023), according to the 2024 M&A Trends Survey.

Figure 1. Up, up, and away: Few CFOs foresee a continued decline in M&A deals over the next 12 months

Do you expect the average number of deals that your company closes to increase or decrease over the next 12 months?

(N=116*) Note: percentages at the top of the bars refer to the percentage of respondents.



*116 (94%) of respondents across eight industries answered.

Source: 4Q 2023 *CFO Signals™*, US CFO Program, Deloitte LLP.

The impact of rising borrowing rates—and the shadow of a looming recession—created a host of thorny issues in the M&A market.

Indeed, some dealmakers have focused on pursuing well-defined strategies (see “Done deals: How companies can make M&A a winning growth strategy,” *CFO Insights*, May 2022). As the 2024 M&A Trends Survey found, 47% of PE leaders and 44% of their corporate counterparts have prioritized defining a coherent and well-supported M&A strategy as the top factor in seeking and executing deals successfully. Deal valuation ranked second for corporate respondents (41%) and third for their peers in private equity (39%).

Rate hurdles

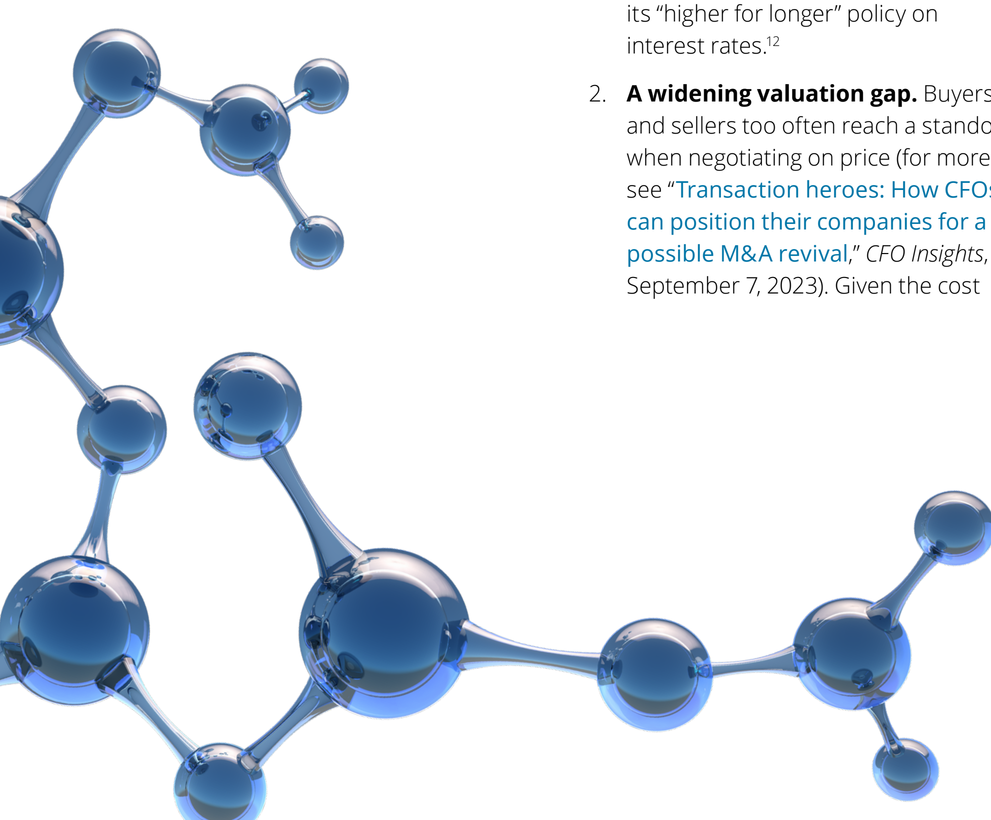
The elevated cost of financing likely accounts for much of the decrease in mega-deals. The impact of rising borrowing rates—and the shadow of a looming recession—created a host of thorny issues in the M&A market. Some still persist, including the following:

1. **A bumpy glidepath down to 2.0% inflation.** While the trend in the Consumer Price Index (CPI) and “core inflation” has been undeniably downward since reaching a high of about 9% in mid-year 2022, the measure has been stickier in the 3% range since Q4 of 2023. Of course, this is a key metric being watched by the US Federal Reserve and driving its “higher for longer” policy on interest rates.[12]

2. **A widening valuation gap.** Buyers and sellers too often reach a standoff when negotiating on price (for more, see “Transaction heroes: How CFOs can position their companies for a possible M&A revival,” *CFO Insights*, September 7, 2023). Given the cost of financing, buyers expect sellers to lower valuations. Sellers, however, see no reason why rising interest rates should lead them to accept lower-than-desired offers. Some deals have recently come to market, improving the prospects for resetting valuations and perhaps narrowing the pricing gap.

3. **A stubbornly closed IPO window.** With public offerings plagued by, among other things, disappointing after-market performances and valuations, many IPO prospects reversed any plans they had to tap the capital markets. The number of formerly fashionable special purpose acquisition company (SPAC) IPOs took a nosedive, plummeting from 600 in 2021 to less than 30 last year.[13] An uptick in initial public offerings, which began in late 2023, does offer hope that the IPO market may turn slightly less volatile and slightly easier to predict. But the highly selective market is likely to experience growth spurts, with a steady stream of deals perhaps not returning until 2025.

4. **Heightened regulatory scrutiny.** New regulations in several global jurisdictions—particularly with respect to antitrust standards and carbon emissions and reporting—also affect cost and value considerations for M&A. Some areas, such as antitrust regulations, typically affect corporations more than PE firms.[14] In the United States, the Department of Justice and Federal Trade Commission have scrutinized (and, in some cases, delayed) major mergers in industries such as Technology, Consumer, and Life Sciences and Healthcare.



Creative processes

The slower pace of dealmaking has given both corporations and PE firms time to turn their attention inward. Some transformational activity may have been driven by the need to take out costs. But the respondents to the 2024 M&A Trends Survey also indicated that their companies were intent on becoming more agile and more technically enabled—and thus prepared to partake in the likely revival of dealmaking activity. More than two-thirds (68%) of the surveyed leaders said their organizations had restructured since early 2020. Another 27% are focused on restructuring now or plan to do so in coming months.

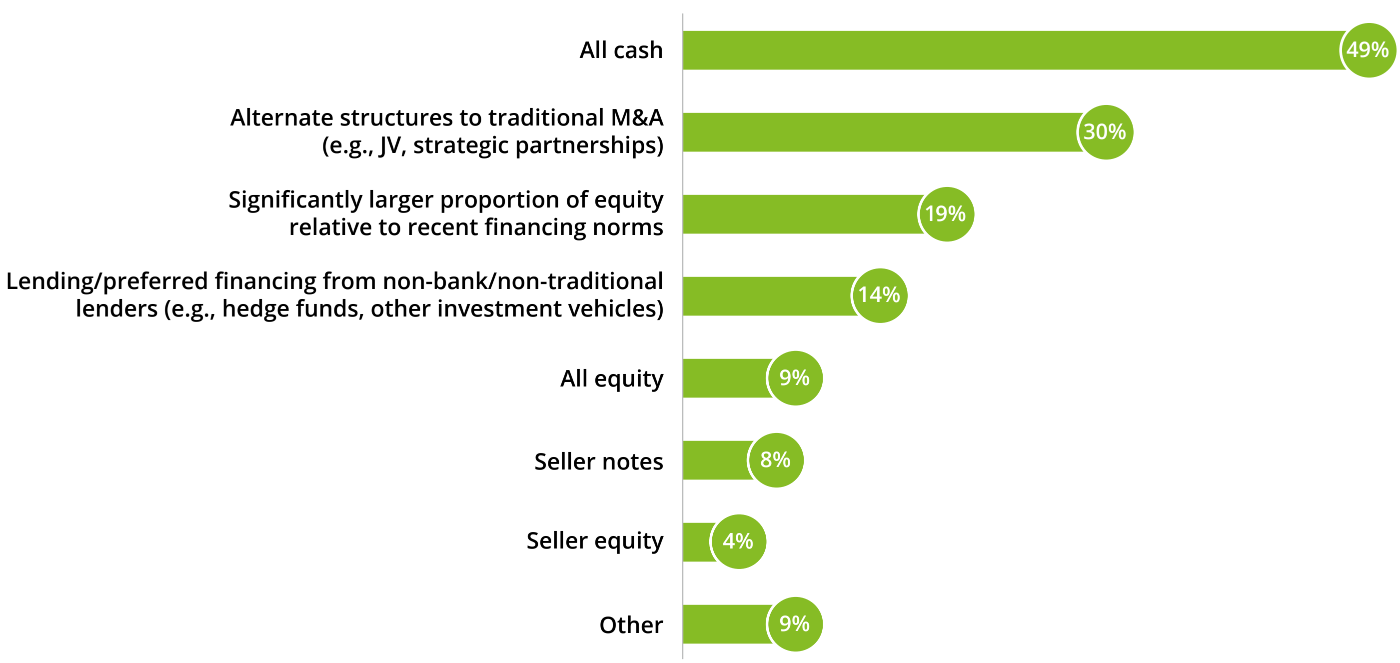
Externally, PE firms and corporations have experimented with creative approaches to dealmaking as they wait for some certainty to return to the debt markets. Some of these innovative approaches, however, could well become permanent features of a transformed M&A landscape. They include those listed below.

- **M&A alternatives.** In the 2024 M&A Trends Survey, 51% of respondents said they have pursued alternative financing sources such as non-bank and non-traditional lenders, while 46% have embraced deal structures beyond M&A. The latter includes tie ups like joint ventures and other types of strategic partnerships. Different types of transactions, such as take-privates, have also emerged in the last year or so. Some of the biggest deals involved all-equity transactions. Of note: In the 4Q 2023 *CFO Signals* survey, about half (49%) of CFOs said their companies were likely to turn to all-cash deals in 2024 (see Figure 2)—a clear indicator of what many finance chiefs think about current borrowing costs.

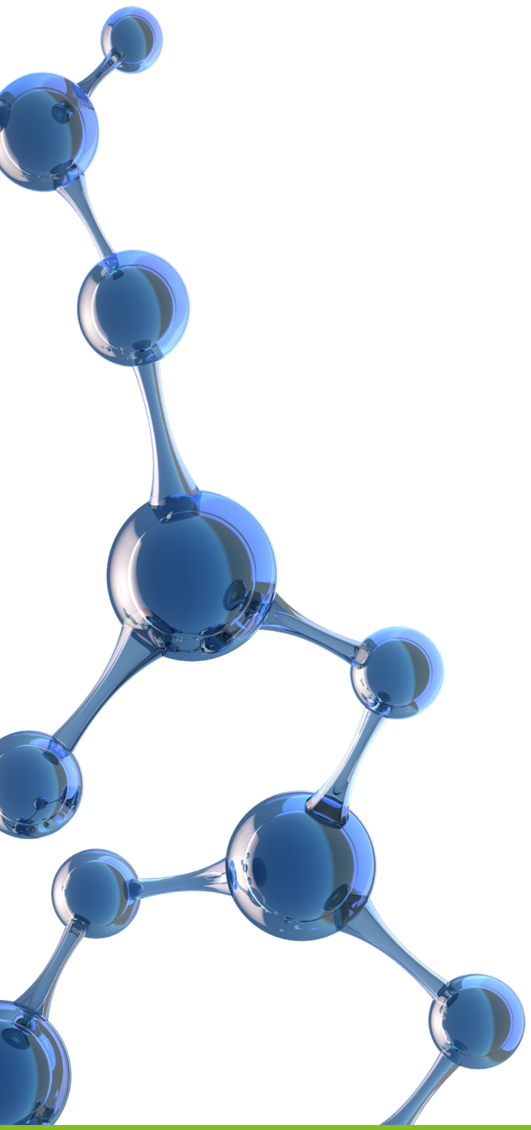
PE firms and corporations have experimented with creative approaches to dealmaking as they wait for some certainty to return to the debt markets.

Figure 2. CFOs are open to alternatives in their search for financing

Which alternative financing vehicles (to traditional bank debt) will your company likely use in the next year (2024) to get deals done? (N=99*)



*99 (80%) of respondents across eight industries answered.
Percentages do not add up to 100% because respondents could select more than one option.
Source: 4Q 2023 *CFO Signals*™, US CFO Program, Deloitte LLP.



- **Integrating AI and other technology.** Among respondents to the 2024 M&A Trends Survey, a surprising 99% indicated that their organizations have begun incorporating GenAI or advanced data analytics into their dealmaking processes. M&A deals tend to be time-consuming and complex, requiring hand-offs from, say, diligence teams to integration teams, and reviews of large volumes of data and information. While users may have abundant concerns about GenAI, the technology holds promise for improving the efficiency of, for example, due diligence and analysis. The increasing use of data analytics tools can offer potential acquirers insights into their targets, pinpointing potential risks.
- **Private credit.** Many buyers have gotten priced out of bank loans and bond markets to finance acquisitions. Conversely, PE buyout funds have been seeking ways to put capital to work, which is unsurprising given the amount of cash on their balance sheets. The result: a private credit market that, while not new, has been growing. Even when the traditional spigots of debt-financing open up, acquirers will likely consider blending those with private credit. While such a mixture could add complexity to deals,the flexibility and speed of using private credit will likely remain appealing.

The sharing economy

In tapping the private credit market, companies may be forging a partnership with a PE firm extending beyond finance. The two may also join forces to tackle operational issues. Collaborations between the two different types of dealmakers may become more common. The 2024 M&A Trends Survey found that corporates and PE firms are seeing each other in a fresh light.

In survey questions, each set of respondents indicated the dealmaking traits they most admired about the other. While companies cited PE firms' technological acumen, for example, PE firms expressed respect for the talent strategies and processes that many companies utilize well. The seeds of such cross-constituency learning may represent a new frontier in M&A.

Of course, corporations and PE firms will continue to approach M&A quite differently. The former typically seek strategic acquisitions, aiming to realize synergy over the long term, while the latter expect to realize ROI on their investment in a three-to-seven-year span. In areas where they can join forces, however, they may have the collective strength to ultimately overhaul and restore a vital M&A market.

Resources: M&A

Acquired a taste for dealmaking? Explore these recent Deloitte reports

- **2024 M&A Trends Survey: Mind the gap:** This report draws on insights from 1,500 US-based decision-makers, the largest cohort in the survey's decade-long history, with respondents almost evenly split between corporations and private equity firms. The first part explores the current and likely future state of M&A, followed by a section devoted to how corporations and PE firms may combine their efforts to drive value-creation opportunities.
- **The path to thrive: M&A strategies for a brave new world:** This 2023 report pinpoints the capabilities companies will need when M&A volumes recover, suggesting a timeframe based on an analysis of nearly 40 years of historical M&A data. In addition, the report outlines how different M&A strategies can help build resilience or fuel momentum.
- **4Q 2023 CFO Signals™:** This quarterly survey drew responses from 124 CFOs, the vast majority from companies with more than $1 billion in annual revenue. The survey's special topic explores finance leaders' plans and expectations regarding M&A. Among its findings: 51% expect M&A to account for 1% to 10% of their companies' growth in the next three years.

End notes

1. "Corporate resilience, uncertainty, and M&A posture through market lows," Deloitte Development LLC, 2021.
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9. "What are the Potential Catalysts for M&A Resurgence in 2024?" Adams and Reece LLP, January 26, 2024.
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11. "Dollar's rally supercharged by diverging US rate outlook," Reuters, April 15, 2024.
12. "Inflation came in hot at 3.5% in March, CPI report shows. Fed could delay rate cuts." *USA Today*, April 10, 2024.
13. "Number of special purpose acquisition company (SPAC) IPOs in the United States from 2003 to August 2023," Statistica, 2024.
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