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Business Owner Advisory

Looking Back at M&A Activity in 2023:

A Lack of Headlines, A Bit of Resilience

- Overall, 2023 was a lack-luster year for mergers and acquisitions (M&A) with higher interest rates, tighter monetary policy and U.S. economic uncertainty combining to dampen deal activity
- However, many deal professionals remain optimistic for a renewed interest in M&A deal-making in 2024 supported by the high levels of corporate cash balances and private equity dry powder that have been recently accumulated during these uncertain economic times
- Business owners who dedicate time to both business exit planning and personal financing planning will be in a stronger position to capitalize on any M&A upswing and help optimize their business exit outcome

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The 2023 M&A landscape, by most metrics, was lackluster and ultimately resulted in the slowest global activity since 2013. The year was marked by the continued hangover from the massive pull-forward in deal activity from 2021, Fed Fund rate increases and general uncertainty around economic conditions. As a result, sellers mostly continued a "wait-and-see" attitude as they sat on the sidelines.

Unfortunately, what stood out was the lack of significant uplift in activity during the fourth quarter, contradicting some mid-year predictions by deal professionals of a stronger year-end. Still, the sub-$50 million deal segment saw nearly 13,500 transactions totaling north of $46 billion in deal value for all of 2023. This small cap segment ended down only 4% in deal value and up 1% in the number of deals, a potential signal that we have reached the bottom for the smallest segment of deals.

As with any year, there were a few predominant forces that ultimately drove deal activity:

HIGHER INTEREST RATES AND TIGHTER MONETARY POLICY:

With the battle of taming inflation ongoing in 2023, the Federal Reserve's continued pace of interest rate hikes, which ultimately leveled off mid-year, was an important factor. Higher interest rates and, in parallel, the generally restrictive credit environment had a profound impact on the appetite for acquisitions.

U.S. ECONOMIC UNCERTAINTY:

The threat of a potential deep recession cast a shadow over the U.S. economic landscape throughout the year, introducing an element of caution into the business environment. While concerns about a downturn persisted, corporations exhibited a remarkable ability to adapt. However, the adaptations fell short of materializing into further M&A activity, as buyers continued to be selective and opportunistic about their acquisition strategy with the increased near-term economic risks.

RESETTING OF DEAL EXPECTATIONS:

Unlike the public markets, where valuations can be seen in real-time, the delay in M&A deal reporting takes time to materialize, causing a lag in the reset of sellers' expectations. In addition, somewhat unbeknownst to sellers, deal terms continued to favor buyers during the year and resulted in the resurgence of "creative" deal terms (e.g. earnouts, rollover equity, and seller financing), which helped bridge some gaps and close deals.

Ultimately, 2023 has been a year of resilience in many ways. While dealmakers continue to have an optimistic tone for the coming year, the path forward is not without challenges.

PREDICTIONS FOR 2024: NAVIGATING POTENTIAL CROSSWINDS

Looking ahead to 2024, the M&A landscape could be poised for renewed activity due to several factors:

GRADUAL LOOSENING OF MONETARY POLICY:

With inflation (relatively) tamed and in hopes of avoiding a recession, the Federal Reserve's management of interest rates will remain a critical factor. Predicted interest rate cuts will almost certainly provide more favorable borrowing conditions for acquirers.

VIABLE SOFT LANDING:

The prior fears of a deep recession have mostly subsided, with more and more economists forecasting a soft landing or no recession at all. This will likely alleviate buyer concerns about short-term economic risks and influence the acquisition strategies for many buyers in 2024.

CASH ON CORPORATE BALANCE SHEETS:

The substantial cash reserves on corporate balance sheets will play a pivotal role in shaping M&A trends in the coming year. Companies, having weathered economic uncertainties and bolstered their financial positions, may deploy their cash reserves strategically to fund acquisitions, enhance competitiveness, and capitalize on market opportunities.

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PRIVATE EQUITY DRY POWDER:

The private equity sector, armed with significant dry powder (~$1T)[1] mostly accumulated during these recent periods of economic uncertainty (~$520B during 2022 and 2023), is poised to be a driving force behind increased M&A activities. Private equity firms, eager to deploy their capital, will likely target attractive investment opportunities, contributing to the M&A landscape. In addition, private equity portfolio companies are at all-time high hold periods, which makes these companies ripe for monetization.

STRATEGIC ADVICE FOR BUSINESS OWNERS

BUSINESS OWNER PREPAREDNESS:

Business owners who dedicate time to both business exit planning, i.e., preparing their businesses to be as attractive as possible, and personal financial planning will be best poised to monetize expeditiously once the M&A cycle upswings. Strategic planning that aligns business objectives with personal financial goals will help enable entrepreneurs to maximize the value of their businesses during transactions.

In navigating the dynamic M&A landscape in 2024, business owners stand to benefit from a strategic approach that encompasses the "3 T's" of exit planning.

In an environment marked by economic uncertainties and M&A potential, business owners who embrace these principles of exit planning and dedicate time and resources to both business and personal preparedness will ultimately position themselves to strategically capitalize on the upswing in the M&A cycle, helping execute a swift and successful monetization of their businesses.

THE 3T'S OF EXIT PLANNING

TRANSITION

Thoughtful consideration must first be given to determining the most likely path forward for the business. For many owners, this involves assessing monetization options through a sale or buyout. For others, this may mean retention of the business multi-generationally, which requires succession plans and strong corporate governance practices.

TIMING

Equally important is the element of timing. Business owners should evaluate their personal runway from the present moment until their envisioned exit. The optimal timing for a transaction aligns personal and business objectives, maximizes value and ensures a smooth transition.

TRAJECTORY

Finally, the consideration of trajectory involves anticipating prospective business opportunities on the near-term horizon that can be captured to improve the business prior to a transition, or, alternatively, can be deemed an opportunity for new ownership.

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[1] "US PE Breakdown", PitchBook, Q3 2023, page 30.

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