M&A Market Analysis

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2013 Middle-Market M&A Outlook

While not quite living up to high expectations, 2012 was a solid year overall in the global M&A market. The number of transactions was modestly below the all-time high reached in 2011, and announced dollar volume was slightly above the year-ago figure. The bellwether U.S. market, which accounted for 40% of deal activity and nearly half of dollar volume, marked an all-time high for transaction count while witnessing a moderate dollar volume decline. During 2012, positive forces such as well capitalized strategics and financial sponsors coupled with widespread credit availability were largely offset by uncertainties related to the global economy, government fiscal challenges, and Europe's debt troubles, causing many prospective buyers and sellers to defer decisions on potential deals. However, global dollar volume in Q4 2012 was almost 50% above the average of the first three quarters of the year and reached the highest level since Q4 2007, possibly boding well for increased M&A activity in 2013.

In view of sound market fundamentals, global M&A activity is poised to expand in 2013:

- **Corporates Capitalizing on Opportunities.** Strategic acquirors are set for a busy 2013, as M&A is still high on the agendas of any corporate boards that have taken a wait-and-see approach of late. Corporates are looking to make appropriate use of large cash hoards (exceeding $2 trillion for U.S. companies) currently drawing a meager return. In addition, the credit markets have recently provided capital at historically low rates to both investment grade and speculative grade issuers. As usual, the middle market should see most of the M&A action, with companies less willing to place major strategic bets in a challenging economic environment. Due to muted growth expectations in developed markets, acquisitions will be a high priority for strategics seeking increased sales, scale economies, and operating leverage. A stabilizing economic outlook puts U.S. companies in position to follow through on planned M&A, while corporate leaders in Europe may remain cautious until GDP growth returns.
- **Private Equity in Prime Position.** After heightened economic and policy uncertainty put many deals on hold late in 2012, financial sponsors have the means and motivation to buy and sell actively in 2013. Private equity firms seeking new platforms as well as bolt-on deals for existing holdings have access to debt capital at attractive terms in addition to more than $400 billion in uninvested committed capital, which has been supported by an improving fundraising environment. The expanding group of portfolio companies held by sponsors includes a large proportion near the end of their investment windows, resulting in sharp focus on achieving exits in 2013. Relative to the equity markets, M&A should remain an appealing means of realizing liquidity, as dollar volume for sponsor-backed IPOs dropped over 50% in 2012.
- **Tepid Economic Climate.** After slowing in 2012, global economic growth appears to be stabilizing at low levels entering 2013, pointing to a satisfactory backdrop for M&A activity. In the U.S., firming housing fundamentals and gradual labor market progress are likely to be offset by the impact of tax hikes on consumer spending. With austerity programs continuing in Europe, the European Central Bank projects a slight decline for the euro zone output in 2013, although a gradual recovery is seen beginning in the second half of the year. Faced with another year of weak economic conditions, Japan's government is planning stimulus measures, while its corporates could remain aggressive outbound acquirors. Growth is expected to pick up in developing markets such as China and India after deceleration weighed on M&A trends in 2012. As in recent years, divergent outlooks for regional economies should fuel cross-border activity in 2013.
- **Favorable Credit Markets.** Based on impressive issuance and fund flow data throughout 2012, the leveraged finance markets brought positive momentum into 2013. With central banks committed to maintaining low benchmark interest rates in 2013, liquidity should continue to flow across the credit markets. Furthermore, demand for yield should remain strong, particularly as global high yield default levels are again expected to track far below historical averages. As in 2012, terms in the leveraged loan market are likely to be more issuer-friendly for deals involving larger companies. In Europe, lagging credit market activity would benefit from better economic trends as well as greater confidence that sovereign debt issues are under control.

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