M&A Market Analysis

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2014 Middle-Market M&A Outlook

Although global M&A dollar volume increased in 2013, the broad-based growth anticipated for M&A activity did not materialize in terms of number of deals. In fact, the M&A transaction count declined 15.2% on a global basis in 2013, falling to the lowest level in four years. In contrast, reported dollar volume rose 5.8% to the highest mark since 2010 primarily due to growth in the billion-dollar-plus deal category. The U.S. M&A market experienced similar trends, with a sharper deal count fall-off at the lower end of the middle market. Several key M&A pieces were in place throughout 2013, including well-funded strategics and financial sponsors with ready access to financing. However, deal-making was dampened by disparate valuation expectations among buyers and sellers amid a rising stock market, as well as global economic concerns and government policy uncertainties. On an encouraging note, dollar volume in the U.S., Europe, and Asia increased by double-digit percentages in the second half of the year relative to the first half, with Europe and Asia also recording second-half deal count growth, possibly boding well for improved M&A market performance in these regions during 2014.

The following text reviews trends and issues relevant to M&A activity in 2014:

- **Strategics Striving for Growth.** After largely staying on the sidelines, corporates enter 2014 with M&A as a central part of their strategic plans. In view of an improved economic outlook, companies are expected to put more emphasis on M&A that achieves expansionary goals rather than cost synergies. Leaders of public companies may feel pressure to enhance growth via acquisitions in an effort to support multiples that expanded during the market rally of 2012-2013. Corporate boards should note that the stocks of public company acquirors significantly outperformed the market in 2013 (according to a Towers Watson study), as strategics were rewarded for using massive cash positions (estimated to exceed $5 trillion globally) otherwise earning a minimal return. Furthermore, financing is widely available to high quality strategics seeking to make transformative deals funded with debt.
- **Financial Sponsors Well Funded.** Private equity firms are positioned for a busy year of transaction activity in 2014. Due to increased equity market valuations, financial sponsors are eager for a repeat of 2013, when private-equity backed companies priced a record number of IPOs and generated peak-level follow-on proceeds. In a premium multiple environment, selling portfolio holdings will remain a priority for sponsors, which still need to exit thousands of the firms bought during the buyout boom of 2006-2007 even after registering growth in exit dollar volume in 2013. In addition, private equity firms have the capacity to be active acquirors on the heels of a strong year for both liquidity events and fund-raising (at a five-year high in 2013) and with access to financing at attractive terms. In an attempt to maintain valuation discipline, sponsors may show a preference for add-on deals that enable scale economies and operating leverage over new platform investments.
- **Economic Recovery Advancing.** After stabilizing in 2013, worldwide economic expansion is projected to accelerate in 2014, suggesting an environment well suited for M&A activity. The U.S. economy appears headed in the right direction, reflecting a resurgence in manufacturing (e.g., automotive, housing, on-shoring), oil & gas production, and consumer spending following unemployment declines and increases in equity and home values. In early January, the IMF noted plans to raise its 2014 GDP growth forecast, which already calls for modest acceleration, based largely on reduced economic and policy uncertainty in the U.S. Trends in the large economies of China, Japan, and the U.K. also support an upbeat global outlook. The euro zone economy is slated to deliver modest growth in 2014 after two years of contraction, thereby promoting cross-border activity involving the region. Moreover, expansion is projected to increase in India and Latin America following a recent slowdown. Government austerity measures across major markets should be a smaller drag on growth in 2014, although the impact of the Affordable Care Act in the U.S. is a new wildcard.
- **Constructive Credit Markets.** The global credit markets face the new year ready to continue financing M&A activity at favorable rates and terms for issuers. Robust investor demand for yield, as evident in consistently positive inflows for leveraged loan funds throughout 2013, should drive momentum in these markets in the first part of 2014. However, following the liquidity-fueled leveraged finance market rally of 2013, the U.S. economy must deliver on expected growth in order to minimize the impact of Fed tapering and to allow corporates to achieve necessary deleveraging after a period of substantial issuance. In Europe, further loosening of capital should support M&A activity if the economy makes anticipated progress and if sovereign debt issues stay out of the headlines.

Christopher C. McMahon
Managing Director
Head of Global M&A
cmcmahon@rwbaird.com
+1.312.609.4983

Brian P. McDonagh
Managing Director
Co-Head Global of M&A
bmcdonagh@rwbaird.com
+1.704.553.6611

Howard P. Lanser
Managing Director
Head of Debt Capital Markets
hlanser@rwbaird.com
+1.312.609.5478