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Merger monthly

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After recording impressive M&A numbers in July and August, dealmakers paused for breath in September

The latest US economic data clearly points to the US economy likely not being in a recession or on the cusp of one. The economy is expected to move forward at a slow to modest pace, with consumers and businesses continuing to spend, albeit more cautiously.

Signs of labor market softness and more benign inflation have led the Federal Reserve to implement its first big rate cut in the last four years, which Fed Chair Jerome Powell claims to be a policy "recalibration" to neutralize monetary policy, rather than a recessionary policy response. While Powell calls the half-point cut "a good strong start" that made sense from "an economic standpoint and also from a risk management standpoint," Fed Governor Michelle Bowman is concerned that the upside risks to inflation remain prominent.

Powell recently signaled that more interest rate cuts are in the pipeline but would occur at a measured pace, intended to support a still-healthy economy. But even as the Fed turns an important corner in its fight against inflation, real risks remain, particularly concerning the cooling of the labor market. And while this is what the Fed always wanted — cooling off an overheated job market — it is clear that they do not want to see it continue.

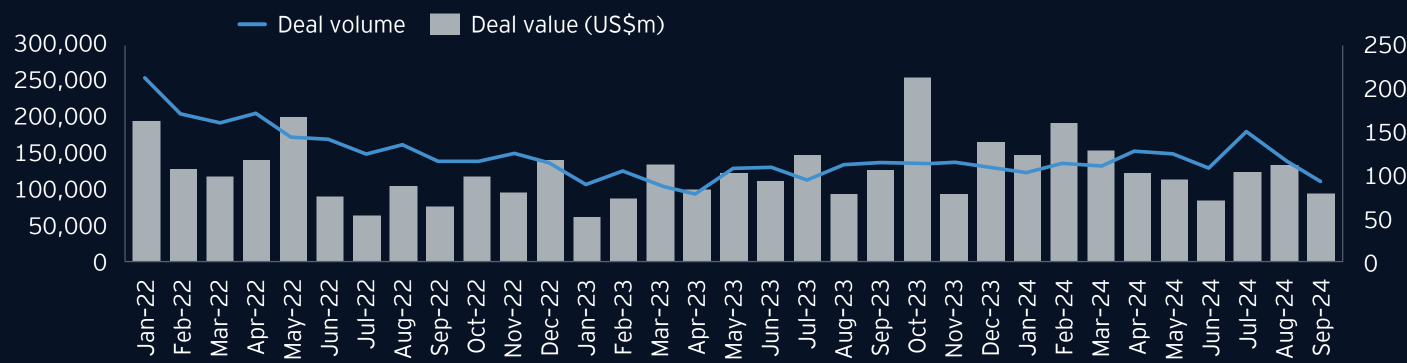
The overall story for the US economy remains positive backed by recent Q2 data, which showed that GDP continued to grow at a strong pace of 3.0%. Moreover, gross domestic income increased at a 3.4% rate, revised up from the initially estimated 1.3% pace. However, economic concerns remain in terms of dependence on the service sector for growth, as September saw only moderate growth in US business activity and a sharp drop in business confidence. Additionally, political uncertainty surrounding the upcoming presidential election and trade policy continues to weigh on business sentiment.

September deal numbers (US$100m+) came out soft, with value and volume down by 25% and 19% year-over-year (YoY), respectively. However, this is likely a temporary dip as firms postpone engaging in significant deals ahead of the elections as they seek clearer guidance on future antitrust enforcement and the shifting interest rate environment. September saw only 23 deals above US$1b vs 33 deals in August 2024 and 38 deals in July 2024. Whether this softness will continue to be seen in October and November, likely not, remains a key question.

In terms of year-to-date (YTD) numbers, the year has fared pretty well, with value and volume both up by 19% YoY. The growth has been particularly pronounced in US$1b–US$10b value range, which saw 229 deals in YTD24 vs. 188 in YTD23 and 184 in YTD22. The surge in deal value is a sign of cautious optimism, as dealmakers engaged in M&A despite external challenges such as persistently high interest rates — despite a recent reduction, continued inflation, geopolitical instability and heightened regulatory scrutiny.

Monthly global M&A trend (2022 onwards)

Deal value (US$100m+); deal volume (US$100m+)



Source: EY Insights analysis and Dealogic

Overall, the deal outlook appears quite positive as **deal fundamentals remain strong, and M&A activity is expected to grow,** driven by strong corporate profits, stabilizing inflation and healthier debt markets. The first US interest rate cut is likely to improve financing conditions, as borrowing costs lower and valuation gap narrows.

This will not only ramp up corporate buyers' deal appetite but also drive private equity (PE) activity. PE firms still have massive pent-up demand, so improving lending conditions should further encourage them to capitalize on opportunities.

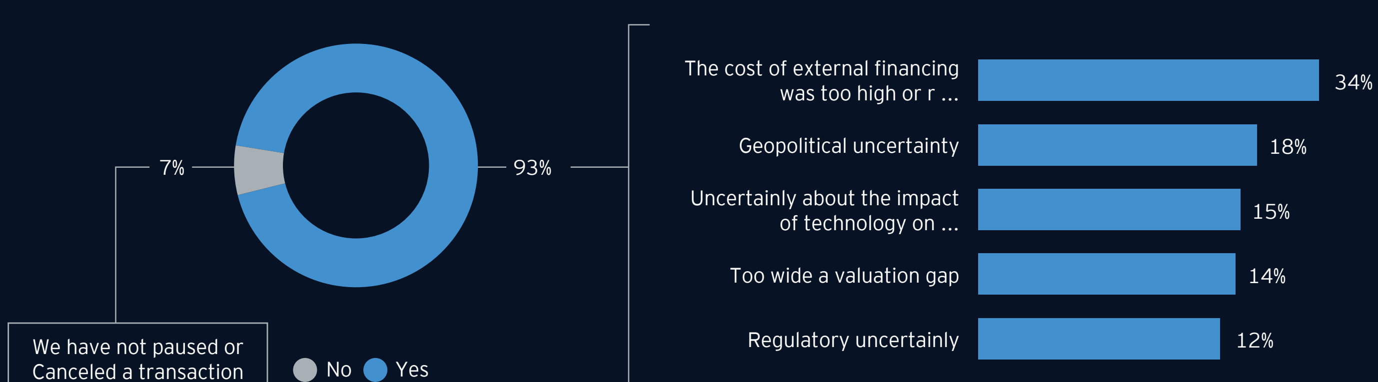
The latest EY CEO Outlook Pulse survey indicates that around 42% of US CEOs are willing to engage in M&A in the next 12 months (slightly more than global number of 37%).

The survey also r**anks the US as the top capital investment destination for the next 12 months,** despite the uncertainty of the upcoming election. The US has been the driver of M&A throughout 2024, contributing to more than half of the global deal value. Inbound deal activity is expected to remain strong as the robust earnings growth of US companies makes them attractive targets for non-US buyers, especially from Europe.

Lower borrowing costs is expected to be a catalyst for M&A

When US CEOs were asked about their reasons for pausing or canceling a transaction in the past 12 months, the most cited reason was the high cost of external financing. Around 34% of CEOs cited this reason for pausing or canceling a transaction vs. 18% who cited geopolitical uncertainty.

Q. Have you paused or canceled a transaction during the past 12 months. If yes, please specify the primary reason.
(The respondents were asked to select one option only)



Source: EY Insights and Dealogic

Now with the easing cycle underway, it would lower the borrowing cost gradually and create a friendly financing environment. Moreover, loan yields are likely to reduce, which could lead to a rise in leverage ratios and better M&A valuations, stimulating additional M&A activity, amid a favorable backdrop in the coming months.

Private equity is likely to drive deal activity driven by interest rate cuts, stronger financing markets and better valuation spreads

PE firms continue to have record levels of committed but uninvested capital, which could fuel more investment deals. With the start of an interest rate easing cycle, leveraged-buyout activity is expected to pick up and will be further bolstered by the easing of bid-to-ask gap. The most recent PE Pulse survey found that 67% of general partners said sellers were dropping asking prices to meet buyers' offers, and 33% saw a combination of both buyers moving higher and sellers moving lower.

Key deal drivers:

- Loosening of credit markets
- Attractive M&A valuations driven by reduced cost of debt
- Demand for generative AI as it compels companies to reevaluate their strategies and business models
- Better economic prospects and easing of recession fears
- Legislative changes, particularly involving financial sponsors, by resolving uncertainty about Delaware law governing stockholder agreements

Additional risks to dealmaking in 2024 include:

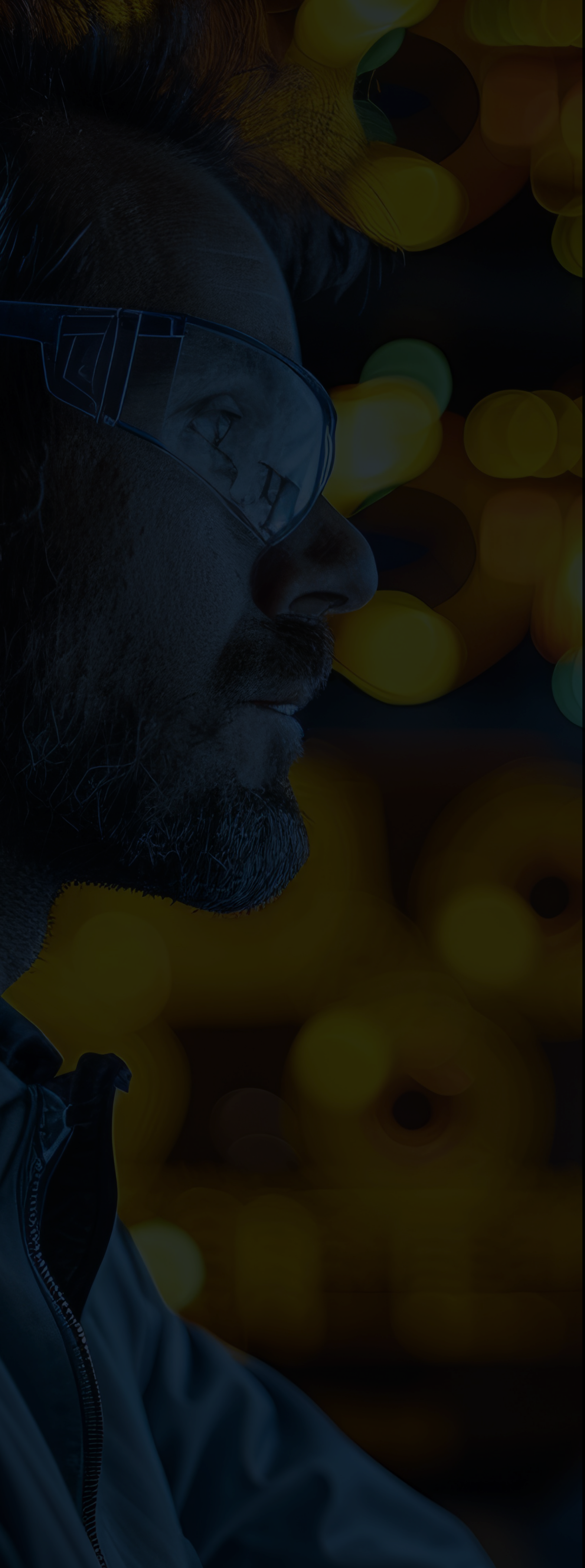
- Geopolitical uncertainty and upcoming November elections
- Intense regulatory scrutiny
- Economic concerns such as weak manufacturing sector and reacceleration of inflation if Fed shifts its focus away from its inflation target

Looking ahead to 2025

2025 is likely to see a strong start, given the robust deal fundamentals and the improved deal appetite of both corporates and PE firms. Given the current deal pipeline, M&A is heading towards a strong rebound next year, following the US elections and as the Federal Reserve further cuts rates to steer the economy toward what everyone hopes will be a soft landing.

The US is likely to benefit most from the return of PE acquirers whose debt-fueled buyouts were hit hard by the Fed's aggressive rate hikes in the aftermath of the pandemic to combat inflation.

US antitrust regulators have increasingly been clamping down on deals they consider anti-competitive. Navigating the increasingly complex regulatory environment will be key to successfully closing deals.



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