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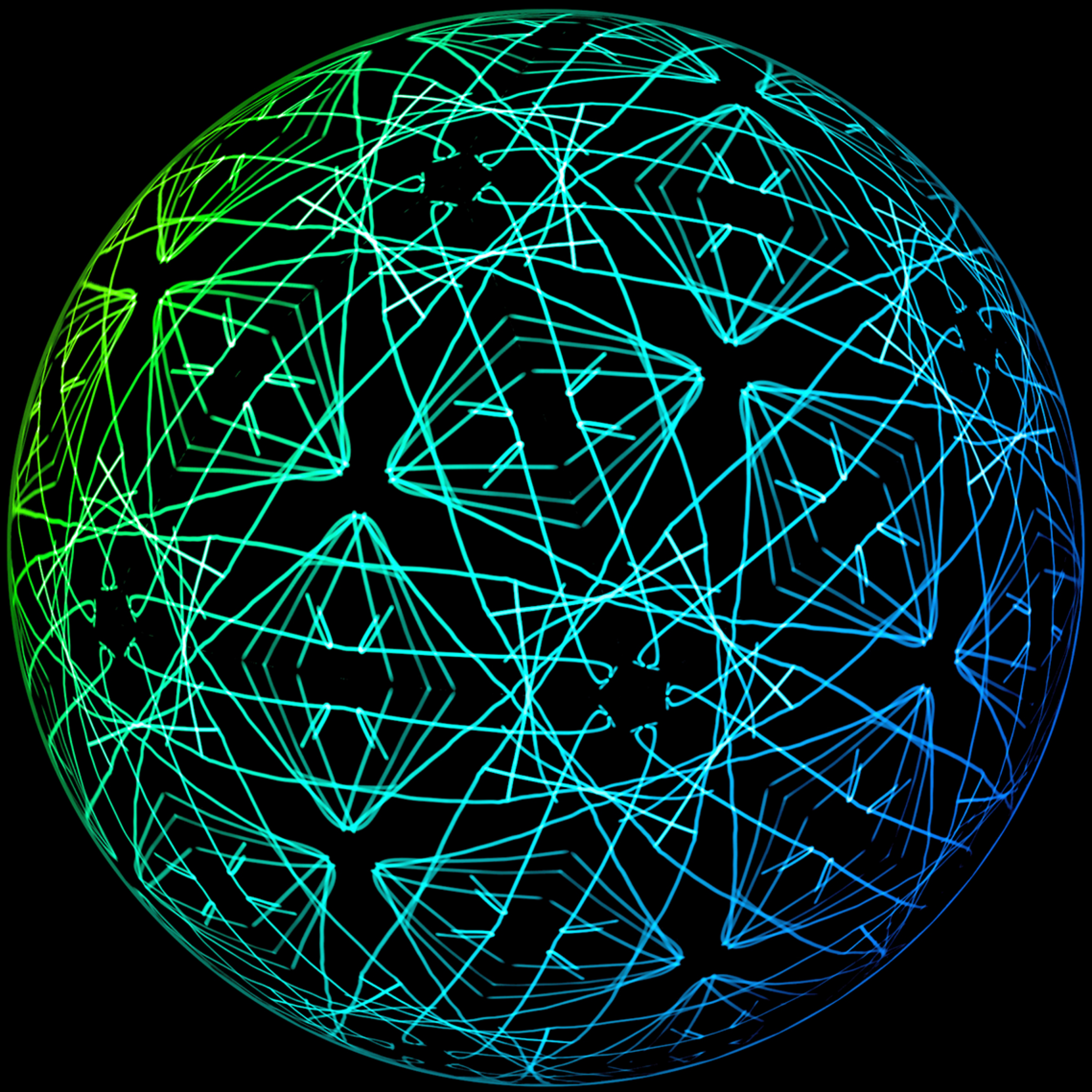
2023 year in review / 2024 industry outlook



2023 Year-in-review

After a period marked by unprecedented M&A activity amid economic stimulus and historically low interest rates, the downturn in the US market that emerged in 2022 persisted throughout 2023. Year over year, the first half of 2023 experienced an M&A deal volume decline of 37% relative to 2022.[1] This trend extended globally, with global M&A declining by 45% over the same period.[2]

Escalating geopolitical tension added layers of uncertainty to dealmaking. These challenges—coupled with heightened regulatory scrutiny, increasing rates, and economic uncertainty—prompted many companies to reassess their approaches to M&A activity, considering factors beyond traditional economic analyses.

Amid various contributors to the declines in the United States, the noteworthy rise in interest rates played a pivotal role. Following a series of seven increases to the federal funds rate in 2022, officials at the Federal Reserve continued rate hikes into 2023, implementing four more over the first seven months of the year. This brought the federal funds rate to its highest level in 22 years, further constraining companies' abilities to access affordable financing.[3] Faced with heightened financing concerns, many companies decided to put their deals and growth plans on hold, instead focusing on their core operations. Adding to the economic shifts, a pivotal event occurred in March 2023 when three high-profile regional banks failed within five days. This development sent shockwaves through the US economy, triggering widespread public and private market uncertainty, with fears intensifying that a US recession was imminent or already underway.

As the year progressed, the M&A outlook became slightly less pessimistic—interest rate hikes slowed, inflation eased, and stock market performance improved. With trillions in dry powder, private equity groups were well equipped to execute transactions and actively sought ways to deploy capital given increasing pressures from their investor bases. However, much of that activity continued the trend that commenced since early 2022 of focusing on add-on investments to existing portfolio companies in lieu of new platforms.

Despite the uncertainty, seller interest rebounded in 2023, with many private and family-owned clients resetting their expectations more quickly than private equity firms, eager to explore options for liquidity. In general, high-quality, recession-resistant business models maintained high levels of interest, with a slower deal market and a supply/demand imbalance resulting in enhanced attention and increased competition. As we reflect on the past year and look to the future of M&A deal activity in 2024, our outlook remains cautiously optimistic. Regardless of the numerous macroeconomic and company-specific headwinds that posed challenges to deal activity in 2023, Corporate Finance practices throughout the Deloitte Touche Tohmatsu Limited network of member firms, more than 2400 professionals across 60 countries were able to complete more than 542 deals.

2024 outlook

Looking forward to 2024, many of the drivers of uncertainty that presented themselves in 2023 are still present. However, there are several reasons to be optimistic about the potential for the US M&A market. Notably, private equity activity—based on our observations over the past three to four months—is displaying signs of a resurgence. Although the cost of capital is still high compared to where it sat in 2021 and early 2022, it has moderately decreased from the highs of 2023. Furthermore, since July 2023, the Federal Reserve has held the federal funds rate flat. This, coupled with recent signals that a series of declines could occur in 2024, may foster a more favorable lending environment over the next year.[4] With private equity groups still sitting on a record-breaking amount of dry powder to deploy, as well as portfolio companies that need to be realized to share cash flow back to limited partners, there is a strong likelihood of increased private equity activity. The prolonged macroeconomic uncertainty has led many groups to extend their holds on portfolio companies, delaying their opportunities to capitalize on potential gain. While some larger investors have established secondary funds and continuation vehicles for these investments, others face mounting pressures from shareholders to realize returns. Similar to the anticipated resurgence in private market activity, the public markets are expected to improve in 2024.

Amid growing optimism regarding potential rate cuts and recent GDP outperformance, the United States is already feeling the effect of improving conditions. The S&P 500 realized its ninth straight week of gains to end the year—the best weekly streak since 2004—and climbed less than 0.2% shy of its all-time closing high.[5]

In the evolving landscape, one phrase gaining traction across the globe is artificial intelligence (AI). Over the next year, there is an expectation that buyers will intensify their focus on the potential impacts of AI during due diligence efforts. For companies planning to go to market, it is increasingly important to have a view on the benefits and potential challenges posed by AI, strategically positioning these factors during M&A processes.

After a year and a half of declining M&A activity, in spite of continued market uncertainty and regulatory hurdles, there is an expectation that many private equity groups and strategic acquirors will likely revisit creative ways to further their growth plans, expedite exits for investments with prolonged hold periods, and deploy capital in 2024. For these reasons, DCF remains optimistic about the 2024 outlook, and we are ready to help the next generation of business owners looking to explore options for liquidity.

1. Boston Consulting Group, *The regional perspective*, October 26, 2023.
2. Ibid.
3. Federal Reserve Bank of St. Louis, Federal funds rate, accessed January 17, 2024.
4. Jeff Cox, "Fed holds rates steady, indicates three cuts coming in 2024," CNBC, December 13, 2023.
5. Samantha Subin and Jesse Pound, "S&P 500 falls slightly Friday, but rides 9-week win streak to end 2023 with 24% gain: Live updates," CNBC, December 29, 2023.

Industry outlooks

Debt markets

During 2023, the private debt markets continued their emergence as a cornerstone of the capital markets amid global economic uncertainties and contraction in the commercial bank market.

Growing market share for private debt
While M&A and financing volume remained muted due to higher rates and economic uncertainty, the slump in the loan syndication market drove meaningful transaction volume to the private credit market, according to KBRA Direct Lending Deals' *November 2023 insights and outlook report*.[1] Per this same report, even though the syndication market started to show positive momentum in the latter part of 2023, significant volume continued to be absorbed by the private debt market as borrowers preferred more flexible financing terms, competitive pricing, and higher certainty of close. There were also several transactions this past year tied to the private markets refinancing large, broadly syndicated term loans. Due to these trends, many investors and lenders accelerated their fundraising for private credit strategies. As a result, private lenders have significant dry powder, positioning the private debt market to potentially thrive in 2024 despite ongoing fluctuations in M&A activities and underlying high interest rates.

Key underwriting trends in 2023
The market dynamics between borrowers and lenders evolved throughout 2023. In early 2023, many lenders were very selective, with a high bar driven by the challenges facing regional banks, higher interest rates, and economic uncertainty. As borrowers continued to weather the storm and rates showed signs of stabilization, many lenders became more comfortable and transitioned to a less restrictive approach on new underwritings. As the year progressed, some lenders became more aggressive with credit spreads tightening for the first time since interest rates started to increase in 2022. As lenders adapted leverage to the higher cost of capital associated with the base rate and an acknowledgment of remaining economic uncertainties, particularly around consumer spending, debt service and fixed-charge coverage ratios became the critical measure for borrowers raising debt facilities.

Key factors
Interest rates, consumer spending uncertainty, and economic variables—which overshadowed pandemic-related concerns in 2022—remained pivotal in 2023. These factors will likely continue influencing the cost of capital, availability of leverage, and refinancing activities in 2024. Despite the ongoing economic challenges, default rates have remained low through 2023, with lenders actively monitoring and managing credit risks, striving to support their borrowers through potential emerging challenges.

Outlook for 2024
While economic uncertainty remains and the full impact of interest rate increases are still to be determined, lending to middle-market companies in 2024 appears to be in a more favorable environment relative to early 2023. Regional banks have continued to solidify their balance sheets and adapt to the new base rates, while the private credit market continues to aggressively deploy creative capital at tightened credit spreads and leverage amounts that reflect the overall cost of capital.

1. KBRA Direct Lending Deals, *November 2023 insights and outlook report*, December 12, 2023.

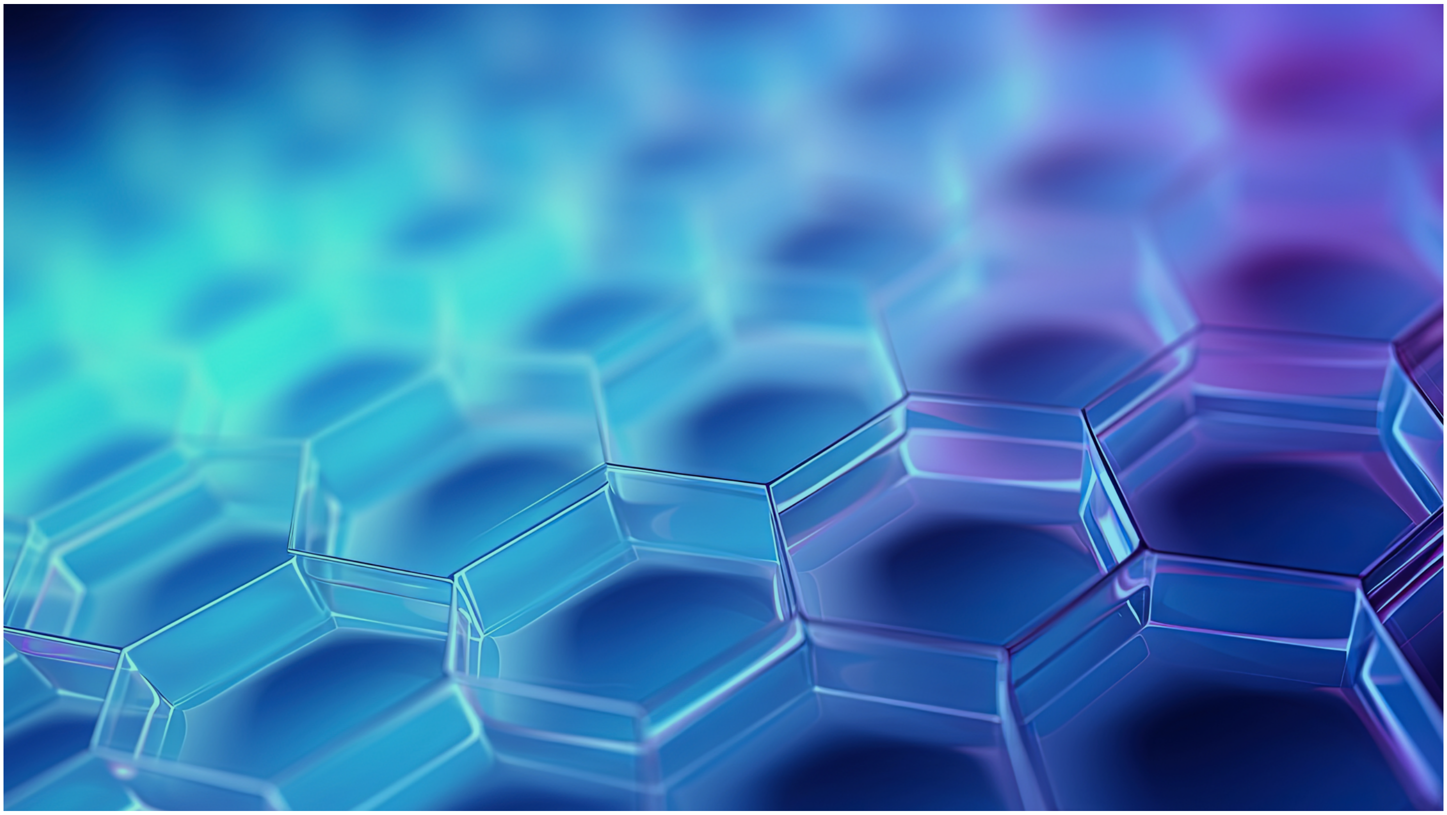
Life Science & Health Care

US health care deal volume declined 2.6% in 2023, while total deal value increased by 50.9%, as investors focused attention on fewer but larger transactions involving premium assets. Despite the shift, interest rate hikes still reduced median valuation multiples by 22.4% from 13.5 times EV/EBITDA in 2022 to 10.5 times.[1]

Inflation and increased interest rates put pressure on operating performance across subsectors in 2023. Health care providers were hit the hardest by increased labor costs, with hospitals and health systems also beginning to recognize the impacts of increased borrowing costs.[2] Another headwind facing health care M&A has been government scrutiny of private equity transactions, especially those related to providers and skilled nursing facilities. In addition to stepped-up Federal Trade Commission anti-trust enforcement, many states—including California—have proposed state-level transparency laws.[3]

In spite of these headwinds, large strategic acquirors and private equity remain well positioned to drive increased M&A activity in 2024. Macroeconomic conditions related to inflation and interest rates are expected to continue stabilizing, allowing investors to renew focus on high-growth areas, including:

- Rising consumerization of health-related products and services.
- Value-based models that improve health outcomes and lower system costs.
- Continued consolidation of fragmented providers and service groups.
- Sustained utilization of telehealth and home-based health care services.
- Employer- and payor-directed health care alternatives.



1. Merger Market, Healthcare deals completed in 2022 and 2023, accessed January 17, 2024.
2. Elizabeth Troval, "Some hospitals struggle as borrowing gets more expensive," *Marketplace*, May 8, 2023.
3. Jessica R. Towhey, "More states increasing scrutiny of healthcare transactions, with skilled nursing targeted," *McKnights* Long-Term Care News, August 15, 2023.

Business and Financial Services

From our perspective, deal activity in 2022 and 2023 for professional and financial services businesses favored growth-oriented platforms with stable demand drivers and challenged those that rode the temporary waves of the pandemic economy and those with significant exposure to the business cycle. This bifurcation will likely remain going into 2024. We expect several key trends that will further differentiate businesses this year, including:

- **Digital transformation and technology integration:** Businesses in the professional and financial services sectors increasingly require investments in technology to increase efficiency and remain competitive from a service-level perspective. While we observed that 2023 was characterized by uncertainty and apprehensions related to generative AI, 2024 will be a year of opportunity for companies making good strategic choices on new tools and features from third-party AI solutions that aim to differentiate and transform their services.

- **Regulatory dynamics:** Businesses that can navigate increasingly complex regulatory environments are in focus for investors. Platforms built around outsourcing compliance activities are riding a rising tide and a recurrent demand profile. For businesses in highly regulated industries, their effective approach to compliance is a source of differentiation and value. Those making proactive investments in systems and processes will likely be the foundations for consolidation in their sectors.

- **Niche expertise:** With growing tech disruption of commoditized services, niche expertise stands as a veritable immunization. Businesses built around deep, specialized knowledge that is difficult to replicate have the foundation to grow in this dynamic environment.

- **Leadership and talent management:** With a myriad of evolving opportunities and challenges, strength of leadership remains a significant factor for investors. Talent is the critical asset in these sectors, and leadership is the source for the necessary clarity of vision, strategic execution, and nimble reactivity that can attract and retain the best talent.

The 2024 outlook is bright for professional and financial services transactions that lean into the opportunities presented above. Companies with proactive positioning should be better able to innovate, scale, expand their offerings, and enter new markets. These themes should mark strong transaction volume and value in the coming year.

Technology, Media & Telecommunications

Despite historical resiliency, M&A activity in the technology, media, and telecommunications (TMT) sector remained below recent highs. Private equity, lenders, and financial institutions remained cautious in the presence of macroeconomic uncertainty and the rapid increase in the cost of capital to effectuate new deals. The resulting impact for TMT companies of all sizes has been to focus on fundamentals—with a particular focus on cash flow—rather than growth at any cost.

Software

Responding to a deceleration in new bookings within the software sector, many companies strategically undertook measures to enhance productivity and control costs. These organizations prioritized aligning workforces to match current demand as a means of demonstrating adaptability and financial prudence to shareholders during this low growth period. Furthermore, with widespread improvements in the field of AI, many companies not only sought solace in leaner operations, but also increasingly harnessed AI to catalyze pivotal developments and amplify efficiencies. The strategic integration of these technologies served as a cornerstone for the sector, driving innovation and resilience in the face of evolving and uncertain market dynamics.

IT services

In 2023, IT services providers experienced a heightened level of investment by enterprises looking to incorporate robotic process automation, AI, cloud optimization, and user interface/customer experience services into their operational frameworks.[1] Given that many of these projects are long term, this demand enabled growth to continue well into 2023 and should translate to strong revenue visibility in 2024. We anticipate sustained momentum for this trend in 2024 and envision that IT services providers will continue to see growth from enterprises that will need to catch up on digital transformation initiatives following temporary pauses in new major technology spending.

Media

Widespread labor strikes among writers and actors, coupled with continued shifts in consumer preferences for digital streaming options instead of legacy cable bundles, set the stage for an uneven year in media. Investors exercised caution, awaiting clarity on forward-looking profitability amid heightened pressures on production and distribution costs.[2] The outlook gradually improved through the latter half of the year, as normal operations resumed, but uncertainty around cost-cutting measures may leave investors hesitant heading into 2024.

As we look ahead to 2024, TMT M&A activity looks cautiously optimistic, as the spread in valuation expectations between buyers and sellers continues to normalize. Several industries are facing disruption and consolidation events, with AI and streaming set for rapid changes in the wake of new technology and evolving consumer behaviors.

1. Splunk, "IT Spending & Budgets: Trends & Forecasts 2024," accessed January 23, 2024.
2. Nielsen, "Streaming grabs a record 38.7% of total TV usage in July, with acquired titles outpacing new originals," August 2023.

Consumer

In 2023, prevailing levels of high inflation and economic uncertainty dampened general M&A activity. Although total deal volume in the consumer and retail (C&R) sector was consistent year over year,[1] the sector faced depressed valuations amid high interest rates, record inflation, declining consumer confidence, market volatility, and other headwinds. The federal funds rate reached a 22-year high of 5.5%, increasing the cost of borrowing capital and consequently challenging many buyers' ability to offer valuations in line with recent years.[2] The aggregate value of C&R deals dropped by 30% from $116.9 billion in the first half of 2022 to $83.0 billion in the first half of 2023, reflecting cautious behavior from investors amid economic uncertainty.[3] Private equity firms faced a slowdown in deal completion due to higher financing costs, while strategic players in C&R continued making acquisitions.[4] In the third quarter of 2023, strategic acquirers made up 74% of deal volume and 90% of transaction value, leaving the remaining 26% of volume and 10% of value to private equity groups.[5] In comparison, private equity activity made up 35% of deal volume and 47% of deal value in 2021.[6]

Certain sectors within C&R were disproportionately affected by negative M&A trends. Pet food and pet care stayed active with more than 40 deals globally in the first half of 2023, on par with historical activity,[7] while the beauty sector saw a decrease to 39 global deals in August year to date (YTD) 2023, much lower than 2022 sector activity of 51 deals as of August YTD.[8] Overall, investors were cautious with investments in the consumer sector, heeding uncertainty in disposable income and post-COVID recovery. A few high-profile, large deals (such as Roark Capital Group's $9.6 billion acquisition of Subway) were highlights for the consumer sector.[9] Analysts predict that financial sponsors may remain sidelined until markets stabilize in 2024.[10] The outlook for 2024 suggests smaller-scale deals with increased frequency of private equity-backed strategic buyers, marking a new normal in market activity and transaction dynamics.[11]

Within the food sector, better-for-you products and packaged snack and convenience foods are benefiting from favorable tailwinds, including normalization of supply chains and increased demand. Consumers' focus on health and wellness has persisted after the pandemic, and many investors are capitalizing on this opportunity. Key deals such as the sale of Whole Earth Brands and Hardie's Fruit and Vegetable Company reflect eagerness to invest in healthy alternative products.[12] Strategic buyer activity has the forefront in the food sector, representing 67.1% of deals transacted through September 2023.[13] This underscores a trend where industry players are maximizing economies of scale and establishing complementary product offerings. Particularly, consumer packaged goods players appear willing to pay higher values for large deals, aiming to generate synergies and create revenue opportunities through acquisitions of operationally mature companies. While overall M&A activity has yet to recover relative to the exceptional levels of 2021 and 2022, the food sector can anticipate sustained activity.

1. LSEG, Refinitiv Workspace, accessed November 29, 2023.
2. Jeanna Smialek, "Fed holds rates steady and pledges to proceed carefully," *New York Times*, November 1, 2023.
3. LSEG, Refinitiv Workspace.
4. Pitchbook, Pitchbook Deal Database, accessed November 29, 2023.
5. Frank Petraglia et al., "M&A trends in consumer and retail—Q3 2023," KPMG, 2023.
6. PWC, "Global M&A trends in consumer markets: 2022 outlook," accessed November 29, 2023.
7. LSEG, Refinitiv Workspace.
8. Connor McLeod, "Beauty M&A update—September 2023," Capstone Partners, September 28, 2023.
9. Connor McLeod, "Food and agriculture market update," Capstone Partners, October 24, 2023.
10. Colin Baker and Eric Castellano, "Private equity firms are champing at the bit for 2024," *Wipfli*, January 2, 2024.
11. Nicole Sheynin, "M&A trends and outlook for 2024," AlphaSense, November 16, 2023.
12. Kroll, "Food and beverage: Industry insights – Summer 2023," 2023.
13. McLeod, "Food and agriculture market update."

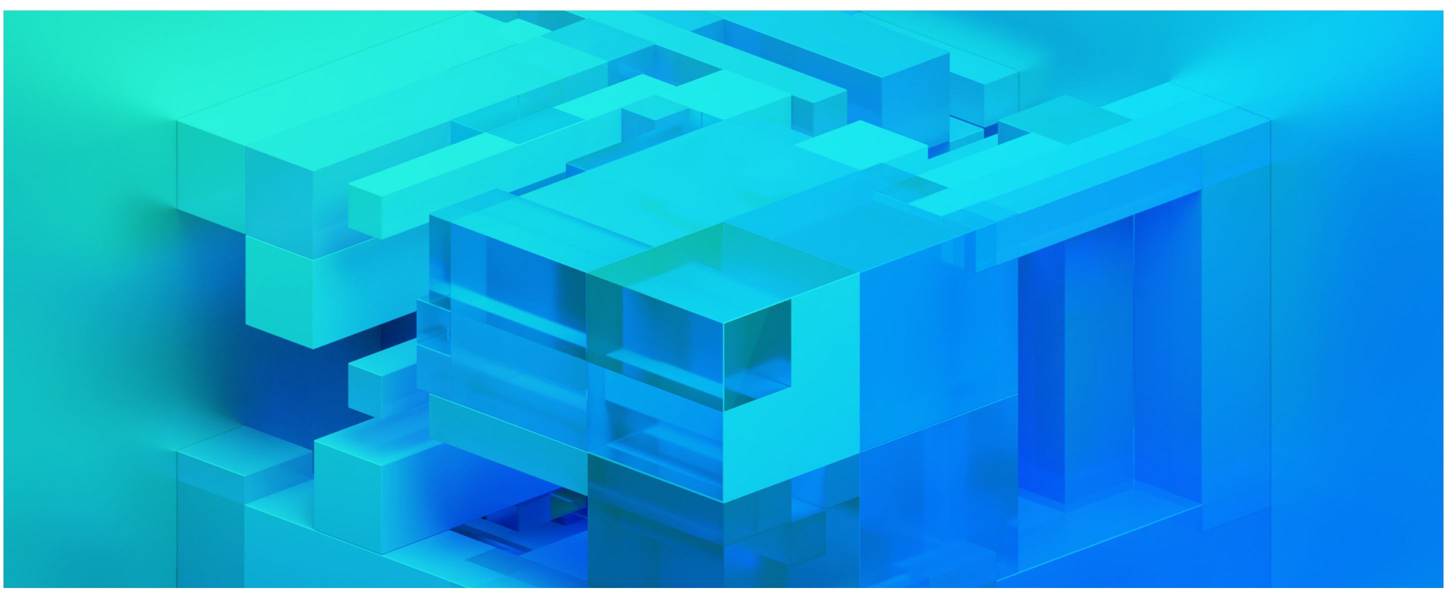
Industrials

The industrial sector deal activity in 2023 remained at moderated levels as buyers and investors remained cautious on the broader economic outlook and interest rates continued their rise throughout the year. On a positive note for the sector, inflation has begun to moderate, raw material costs are stabilizing, and logistical costs are decreasing from their extreme levels in the previous two years—all helping to reduce margin volatility. However, skilled labor shortages, labor disputes, and medium/long-term customer demand and supply chain disruptions continue to pose threats to the sector, albeit at lower levels than recently experienced.

The broad industrials sector has begun to capitalize on the momentum generated by three significant pieces of legislation that were signed into law in 2021 and 2022: the Infrastructure Investment and Jobs Act, the Creating Helpful Incentives to Produce Semiconductors and Science Act, and the Inflation Reduction Act. By introducing an infusion of funds and tax incentives into US manufacturing across various sectors—including semiconductors, clean energy components, electric vehicles, batteries, and the constituent parts and raw materials of these products—these acts have spurred record private-sector investment in the manufacturing industry.[1] As of November 2023, annual construction spending in manufacturing stood at $210 billion, representing a 59% year-over-year increase.[2]

The high level of capital investment activity in 2023 sets the stage for 2024 to potentially be a year of strong demand and profitability, albeit with some continued headwinds. As these benefits are felt across sectors and "predictability" returns to the market, we expect deal activity to increase with an uptick to be felt in the second half of 2024. Key themes for investors and corporates to focus on include:

- The clean energy transition, which is just as much of a focus for many industrial companies as it is for energy companies.
- Strategies for access to critical components along with stabilizing and/or reshoring of supply chains.
- Automotive ecosystem consolidation, especially in the areas of alternative fuels, autonomy, and emerging technologies.
- Digital capabilities, such as automation and AI, especially as labor shortages continue to be a challenge.
- Building efficiencies and resilience into supply chains through vertical integration and reshoring efforts.
- Disruption in the transportation sector given the dramatic change in rates and consumer sentiment concerns.
- Transportation market recovery as economic optimism signals increased shipping demand closing gap with supply and also as trucking capacity continues to shrink.



1. John Keilman, "America is back in the factory business," *Wall Street Journal,* April 8, 2023.
2. US Census Bureau, "Total construction spending: Manufacturing in the United States – November 2023," Federal Reserve Bank of St. Louis (FRED), accessed January 17, 2024.

Representative Deloitte Corporate Finance transactions in 2023

ARGI Financial Group LLC

has been acquired.

The undersigned acted as exclusive financial advisor to ARGI Financial Group LLC

Deloitte Corporate Finance LLC

McAnally Wilkins, Inc.

has been acquired.

The undersigned acted as exclusive financial advisor to McAnally Wilkins, Inc.

Deloitte Corporate Finance LLC

NS Brands, Ltd.

has been acquired by

Blue Road Capital

The undersigned acted as exclusive financial advisor to NS Brands, Ltd.

Deloitte Corporate Finance LLC

Winklevoss Technologies, LLC

has been acquired by

Perseus Group, an operating group of Constellation Software, Inc.

The undersigned acted as exclusive financial advisor to Winklevoss Technologies, LLC

Deloitte Corporate Finance LLC

An Oscar-winning film and television production company

has sold a collection of films to

An industry-leading content investment firm

The undersigned acted as exclusive financial advisor to the production company

Deloitte Corporate Finance LLC

JohnsByrne Company

has been acquired

The undersigned acted as exclusive financial advisor to JohnsByrne Company

Deloitte Corporate Finance LLC

Accord Carton Co.

has been acquired by

Mason Wells, Inc.

The undersigned acted as exclusive financial advisor to Accord Carton Co.

Deloitte Corporate Finance LLC

White Flyers Target LLC

has been acquired by

Olin Corporation

The undersigned acted as exclusive financial advisor to Reagent Diversified Holdings, Inc.

Deloitte Corporate Finance LLC

Deloitte.