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Boards Are Eyeing Deals Again as Market Ticks Back Up

We invite you to read this complimentary article published in Agenda, a Financial Times Specialist publication. In this article, BDO's Jonathan Hughes discusses the current state of M&A and how boards should be responding in terms of strategy. He also highlights the importance of carefully vetting opportunities, maintaining discipline, and optimizing strategies for navigating market uncertainty.

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Boards Are Eyeing Deals Again as Market Ticks Back Up

Companies are getting back into transaction mode, sources said

By Frederic Lee | October 30, 2023

M&A activity increased globally in the third quarter of 2023, according to research from WTW, which found that global deal volume rose 16%, with 151 deals over $100 million in value completed during July to September, "making it the busiest quarter of the year so far."

The data comes after a slowdown in dealmaking that has persisted all year. Now, M&A transactions are starting to play a larger role in companies' strategic plans as they explore growth through inorganic transactions, said David Dean, managing director for M&A at WTW. Boards should ensure that any deal aligns with the company's long-term vision and that the deal's financials will meet the hurdle rate of the acquisition, he said.

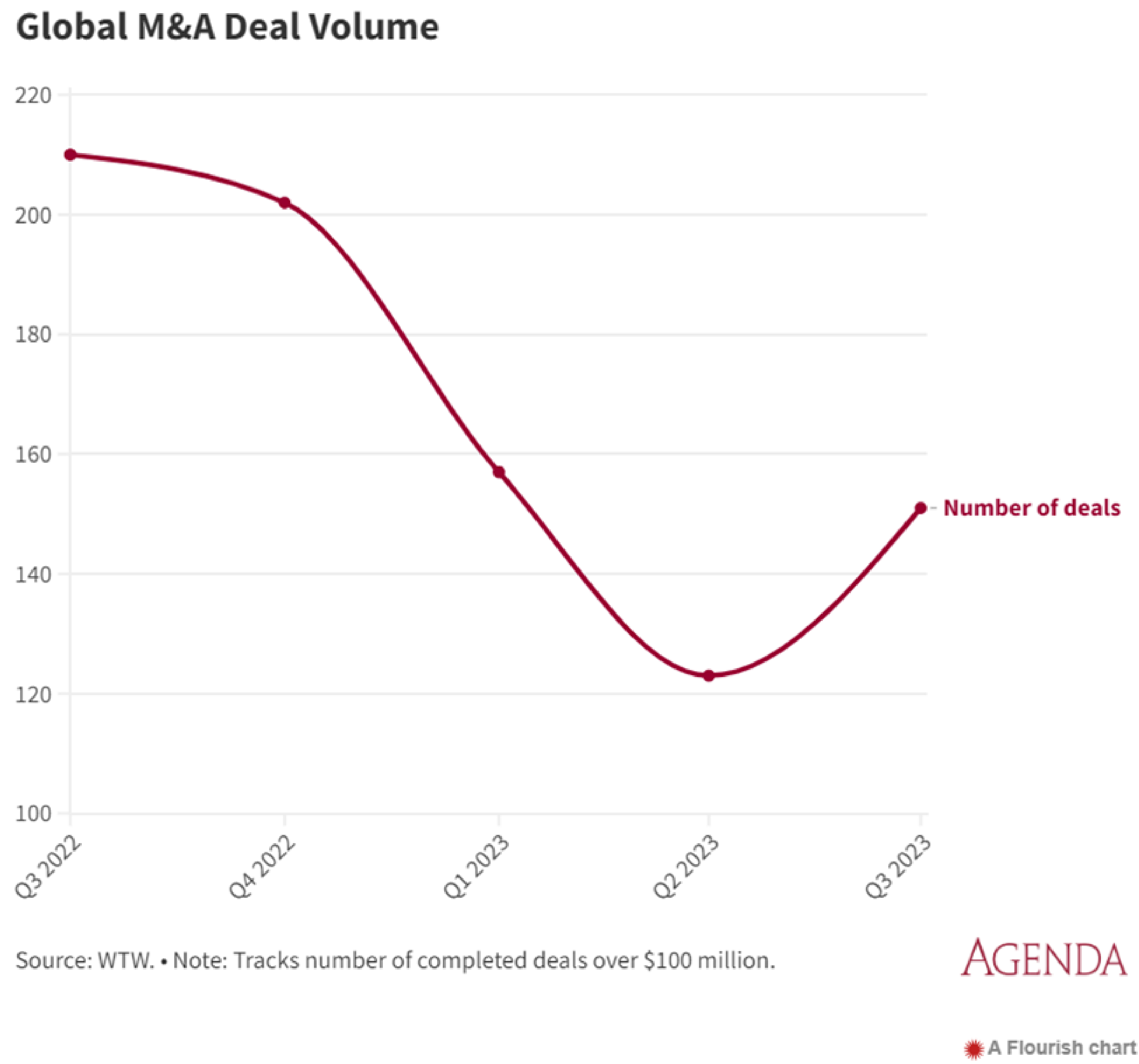
North American buyers completed 77 M&A deals in the third quarter — a 12% increase over the previous quarter — and buyers from Europe completed 32 deals over the same time frame, which represents an increase from both Q1 and Q2, according to the WTW research. Yet, North American and European acquirers underperformed their regional indices by negative10.3 percentage points and negative 3.4 percentage points, respectively.

Jonathan Hughes, managing principal of the management consulting practice at BDO, told Agenda that if boards want to deliver better-than-market returns, they need to embrace contrarian thinking in terms of M&A and encourage the same in their executive teams. "While there is a degree of safety in following the market, whether it is characterized by caution (as is the case currently) or M&A exuberance (as was the case in 2022), doing so means missing opportunities to outperform," he wrote in an email.

There are deals to be had now that will only become more expensive as the M&A market heats back up, and during the next peak cycle of M&A activity, boards need to maintain discipline, "lest they sign off on deals that they later regret," warned Hughes.

Executive teams and boards need to carefully vet M&A opportunities, ensure they have a clear view of the strategic rationale for the deal and see to it that this strategic rationale is used to define a clear integration strategy, followed by a detailed integration plan, said Hughes. He added that boards need to avoid the human tendency toward recency bias, while also recognizing that current geopolitical and macroeconomic uncertainty is very likely to continue.

Many signs point to higher M&A activity next year, but the only thing boards can know with certainty about 2024 is that it will look different from 2023, Hughes said. He added that boards need to ensure their companies' M&A strategies are optimized for navigating market turbulence.



Don’t Call It a Comeback (Yet)

“While it is too early to call a comeback, the recent rebound in deal volume across regions indicates pent-up demand, with M&A activity anticipated to improve as dealmakers enter the final and busiest quarter of the year,” said Dean, in a statement.

Meanwhile, based on share price performance, buyers underperformed the wider market by negative 8.7 percentage points for deals completed in Q3 — the worst quarterly performance since WTW’s M&A study began in 2008, according to the report. WTW attributed the underperformance to “macroeconomic pressures.” Share-price performance in the WTW quarterly study is measured as a percentage change in share price from six months prior to the announcement date to the end of the quarter. The study is run in partnership with the M&A Research Centre at the Bayes Business School of the City, University of London.

Dean said that based on the new data, acquirers aren’t performing as well compared to their market indices in the third quarter as they did in the first and second quarter, which could stem from the lack of confidence in the market on the deals that are being done.

Deals going forward will likely be characterized by a more balanced allocation of value between buyer and seller than what dealmakers saw in 2022, during which sellers realized record valuations, or 2023, when buyers found some low-priced bargains, Hughes said.

Many companies have been overly reliant on inorganic growth and need to be more strategic about dealmaking, he continued.

“As we come out of the recent lull in M&A activity, boards and executive teams should maintain or increase dealmaking discipline,” said Hughes. He added that they should go beyond traditional deal valuation approaches and employ a differential deal analysis, which involves comparing the risk-adjusted financial return and strategic benefits of an acquisition against alternatives including investments to drive organic growth, or the use of strategic alliances and joint ventures.

In terms of global M&A, the Asia Pacific region continues to be the only one to outperform its regional index, according to the report. “With the exception of the energy/power and industrials sectors, where M&A deals recorded a marginally positive performance of +1.5 percentage points and +1.9 percentage points, respectively, compared with non-acquirers in their markets for the year to date, all other industries, including high technology (negative18.5 percentage points) and financial services (negative 7.2 percentage points) have underperformed,” it said.

Typically, said Dean, the fourth and first quarters tend to be busier quarters for M&A transactions, so the uptick in deal volume could continue. “More and more companies are starting to get back into transaction mode,” he said.

Hughes told Agenda that he expects M&A activity to increase in 2024. “The consensus among experts is that the [Federal Reserve] will reduce interest rates in 2024, though the change will likely be slow and gradual — bringing the cost of capital down, though still keeping it above recent years.” Further, Hughes said he expects “cash-rich” life sciences corporations to increase acquisitions of smaller, “cash-low” companies next year.

Larger deals, those valued over $1 billion, have seen a continuous, steady decline in volume that began in 2021, with 32 deals closed in the third quarter, according to the research from WTW, which stated that for the same quarters in 2022 and 2021, 50 and 67 large deals were completed, respectively.

Big Deals

In the U.S., Cisco announced last month it would acquire cybersecurity company Splunk in an all-cash deal worth $28 billion. Berkshire Hathaway Energy announced in July that it had reached an agreement to acquire Dominion Energy’s limited partnership interest in Cove Point LNG for $3.3 billion, with the transaction closing Sept. 1. Further, Beacon Roofing Supply Inc. announced in early July that it had completed its acquisition of Crossroads Roofing Supply, Inc., for $804.5 million, and ratings company MSCI Inc. announced Aug. 14 that it had entered into an agreement to acquire the remaining 66% of The Burgiss Group for $697 million.

Outside the U.S., the British corrugated packaging company Smurfit Kappa Group acquired Atlanta-based WestRock for $21 billion in September. Chinese company Guangdong Kaihong Technology Co., Ltd., acquired Xinneng Mining Industry Co., Ltd., from ENN Natural Gas Co., Ltd., on Sept. 28 in a deal valued at $1.4 billion. Health care and pharmaceutical company Sanofi, based in Paris, announced the completion of its acquisition of U.S.-based health and wellness brand Qunol on Sept. 29 for $1.4 billion, and Japan-based real estate investment and services company Open House Group Co., Ltd., completed the acquisition of a 93% stake in Sanei Architecture Planning Co., Ltd., from a shareholder group for $685.6 million on Sept. 28.