M&A outlook points to gradual rebound in deal market in 2024

EY-Parthenon Deal Barometer
January 2024

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The EY-Parthenon Deal Barometer indicates recovery in the 2024 M&A outlook based on economic and market indicators.

In brief:

01 The new EY-Parthenon Deal Barometer includes an outlook of recovery for M&A activity in 2024, with US private equity deal volume up 13% and corporate M&A up 12%.

02 The Deal Barometer leverages the EY-Parthenon Macroeconomics team's outlook for economic and financial market indicators to predict M&A trends.

03 Being proactive, rather than waiting for interest rates to fall, appears to be an important strategy for capturing growth opportunities.

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Dealmaking activity has gone through a unique cycle over the past three years. Deal volumes reached historic highs in 2021 and early 2022 driven by an extraordinary combination of moderate inflation, strong economic activity, elevated company earnings and, most importantly, decades-low interest rates.

However, in March 2022 the Federal Reserve embarked on a historic tightening cycle reacting to an environment of persistently elevated inflation. As the cost of capital rapidly surged, slower global economic activity, increased macroeconomic uncertainty and heightened geopolitical tensions led to a severe pullback in dealmaking activity.

In 2023, US private equity (PE) deal volumes are likely to be 27% lower than the peak observed in 2021 and down 19% vs. 2022. US corporate M&A transactions (for deals valued over $100 million) are expected to be down 38% in 2023 compared to the 2021 peak and down 9% relative to 2022.

Looking ahead to the 2024 M&A outlook, the EY-Parthenon CEO outlook survey points to renewed CEO enthusiasm for deal activity. Over the next 12 months, the survey found, 52% of US CEOs plan M&A, considerably higher than our global survey, which found only 35% planning deals. In addition, 58% of CEOs plan to divest an asset in that period as leaders seek to fund capital spending in multiple areas.

High on the CEO agenda is forming joint ventures or strategic alliances with third parties (63%) as leaders contemplate lower-risk ways to embrace innovative technologies. Notably, all CEOs surveyed are making or planning significant investments in generative AI (GenAI), with the caveat that many remain uncertain about the direction the technology will take.

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01 New EY-Parthenon Deal Barometer supports CEO M&A optimism

Macroeconomic factors and market indicators point to US M&A rebound in 2024.

Our new EY-Parthenon Deal Barometer indicates that this CEO optimism is well founded, as it points to a gradually rebounding M&A market in 2024. The Deal Barometer uses the EY-Parthenon Macroeconomics team's outlook for economic and financial market indicators to predict future trends in corporate M&A and PE deal activity. Over the last 35 years, it shows a correlation of 98% between PE deal activity and GDP growth, inflation, corporate profits, and short- and long-run interest rates. The correlation between M&A activity and these economic indicators plus CEO confidence is around 75%, pointing to robust predictive power.

As we enter 2024, the EY-Parthenon Macroeconomics team foresees modest and desynchronized global economic activity with downside risks from elevated geopolitical tensions and tightening financial conditions. Still, the US economy is likely to continue outperforming its peers in terms of GDP growth, with profit margins likely to stabilize and slowly turn higher by the end of 2024. With inflation cooling faster than expected, the Federal Reserve has reached the end of its historic tightening cycle. While officials have embraced a higher-for-longer interest rate paradigm, the Fed will very likely proceed with policy rate cuts next year, putting downward pressure on interest rates across the yield curve.

As such, it appears that a proactive strategy of acknowledging and adapting to a higher cost of capital environment will be the most rewarding business strategy. Waiting for rates to fall back to their pre-pandemic levels is bound to be a losing proposition, as it would mean forgoing potential growth opportunities.

The rationale is clear: If scrutinized business decisions make sense in a higher cost of capital environment, they will turn out to be even more profitable when refinanced, as interest rates are more likely to decline than rise over the next three to five years.

Furthermore, companies with generally healthy balance sheets can forgo debt and instead deploy their own capital. Firms that can generate more liquidity and working capital will not only be more resilient but also better able to deploy excess cash to finance M&A activity. Therefore, the higher cost of capital environment should not represent an insurmountable barrier for transactions.

02 M&A market expected to rebound in 2024

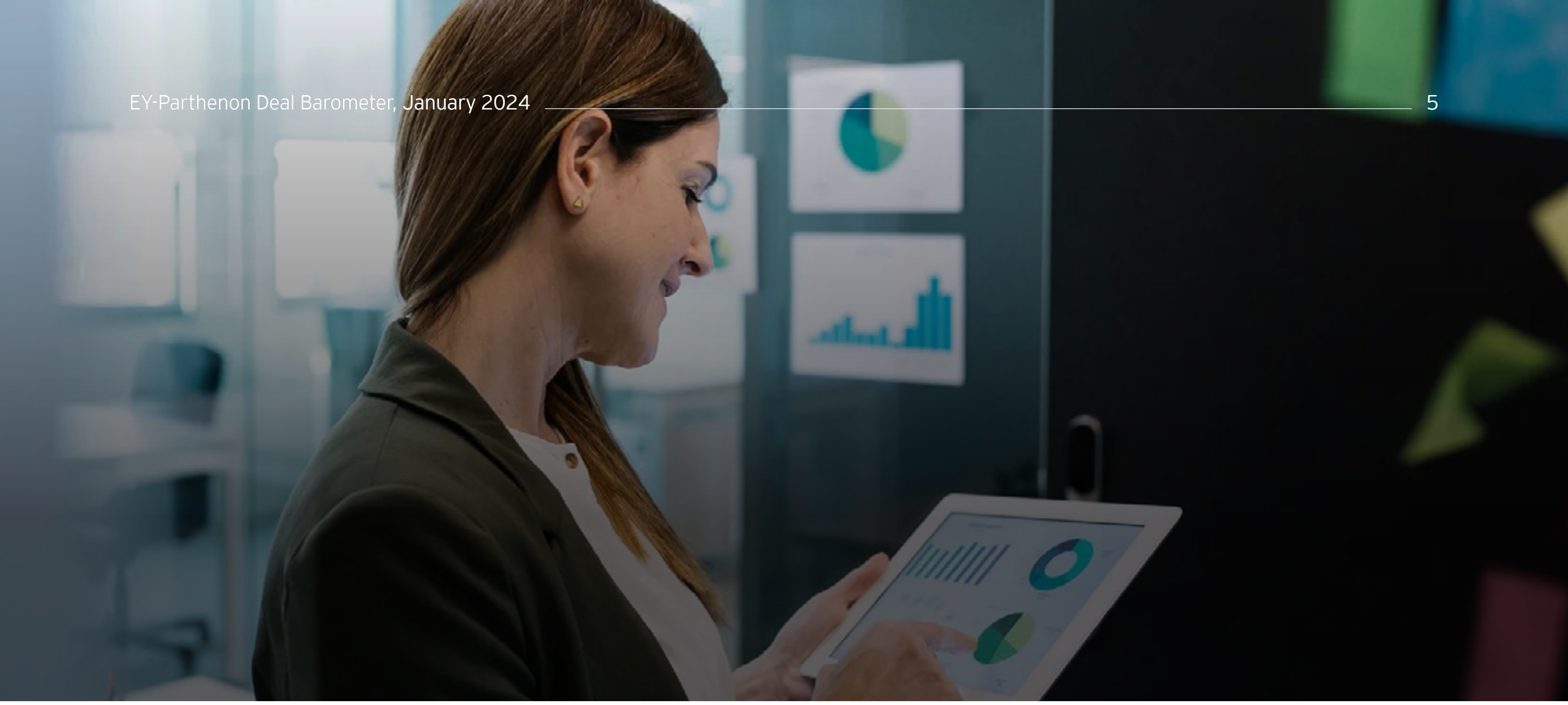
The EY-Parthenon Macroeconomics team sees a soft landing for 2024, with Fed rate cuts likely starting in Q2.

While the EY-Parthenon Macroeconomics team sees a soft landing as the base case for 2024, the odds of a US recession remain around 50%. Hiring restraint and strategic resizing decisions will continue, but we currently don't anticipate a severe employment pullback. Slower employment and wage growth will constrain disposable income growth, but generally lower inflation, and outright deflation in some goods categories, should support spending. The expectation is for real GDP growth to drift below trend growth through Q2 2024 but then gradually rebound, with real GDP growing a modest 1.4% in 2024.

With the Fed's favored inflation gauge — core personal consumption expenditures (PCE) inflation — likely falling below 2.5% in the spring, the Fed will likely deliver its first rate cut in Q2 2024. Roughly 75 to 100 basis points (bps) of rate cuts are likely in 2024 and another 150bps in 2025.

Based on the EY-Parthenon Macroeconomics team's US economic outlook, the EY-Parthenon Deal Barometer estimates US PE deal volumes are likely to rebound 13% in 2024. While this would still leave deal volumes below the 2021 peak, it would represent a faster pace of growth than the average 9% annual pace of growth from 2010 to 2019.

For corporate M&A, the Deal Barometer expects M&A activity to gradually pick up through next year, rising an average of 12% in 2024. We largely anticipate a return to the pre-pandemic levels of activity, with the number of deals in 2024 only about 2% below the average number of deals in 2017–19.



EY-Parthenon Deal Barometer: forecasting framework

Our framework considers factors such as GDP growth, corporate profits, corporate bond spreads, and changes in short- and long-term interest rates. We also consider CEO confidence[1] as a driver of corporate activity. For our analysis of corporate M&A deals, we focus on deals that are publicly disclosed and have a value of over $100 million.

By using this framework, we can provide business executives with an objective perspective on the volume of US PE and corporate M&A activity in the coming quarters. The EY-Parthenon Macroeconomics team's deal volume outlooks are informed by three distinct scenarios for the US economy:

Baseline scenario	While signs of economic strength over the summer will likely fuel speculations that the economy is reaccelerating, we do not expect such strong momentum to be sustained. The recent rapid tightening of financial conditions spurred by surging bond yields represents a material headwind for business investment and consumer spending. With myriad headwinds persisting, including tighter credit conditions, the restart of student loan payments, uncertainty regarding the lagged impact of monetary policy and a fragile global economic backdrop, real GDP growth is likely to drift below trend for several quarters.
Optimistic scenario	In the optimistic scenario, real GDP growth doesn't slow much, as the US consumer shows resilience supported by more robust disposable income growth while businesses turn more optimistic about the outlook, focusing on long-term investment and hiring decisions. Importantly, stronger supply conditions and rebounding productivity mean growth is noninflationary, allowing the Fed to gradually ease monetary policy, supporting some easing in global financial conditions.
Pessimistic scenario	The pessimistic scenario features an undesirable combination of higher inflation and slower growth — stagflation. Higher inflation prompted by supply deficiency across multiple sectors, geopolitical fragmentation and rising commodities prices from global tensions restrains consumer spending. A more hawkish Fed and rapidly tightening financial conditions lead businesses to retrench with a severe pullback in employment and investment. The economy heads into a pronounced recession.

03 In focus: US private equity deal outlook

The PE deal volume outlook is up 13% in 2024, surpassing pre-pandemic levels.

The EY-Parthenon Deal Barometer anticipates a gradual recovery in PE M&A activity through 2024 (Figure 1) following a 19% contraction in 2023. It predicts a 13% increase in PE deal volume in 2024, which would still leave deal activity about 8% below the 2022 level and 18% below the 2021 peak.

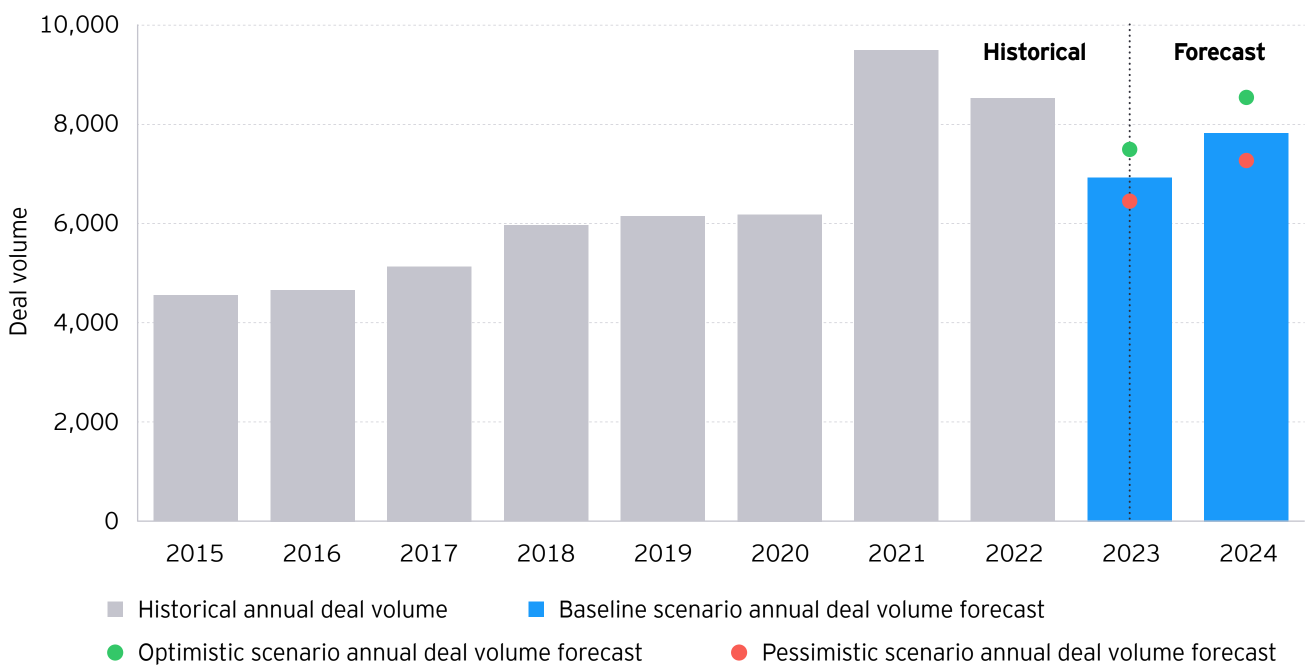
While the shortfall relative to recent peaks will be notable, the more important development is that PE deal volume growth is likely to surpass its pre-pandemic pace next year. Between 2010 and 2019, PE deal volume grew at a 9% compounded annual growth rate (CAGR).

In our optimistic macroeconomic scenario – where growth is stronger, inflation cooler and interest rates lower – deal volumes would rise faster in 2024, up 28% year over year (y/y). This would be triple the pre-pandemic pace of growth, meaning deal volumes would be only 3% below where they would have been absent a COVID-19 crisis.

In our pessimistic macroeconomic scenario – where growth is weaker, inflation hotter and interest rates higher – deal volumes would rebound with a delay and much less in 2024, showing modest y/y growth of about 2%. In this scenario, deal volume would trail the 2021 peak by 29%.

Figure 1: US PE deal volume

Our baseline outlook suggests deal volume has found a floor and will finish 2023 ~19% below last year before seeing a ~13% recovery in 2024.



Year-over-year growth	2015	2016	2017	2018	2019	2020	2021	2022	2023F	2024F
Baseline		2%	10%	16%	3%	1%	53%	-10%	-19%	13%
Optimistic									-16%	28%
Pessimistic									-23%	2%

04 In focus: US corporate M&A outlook

We see M&A activity gradually increasing, reaching 12% gain y/y in 2024.

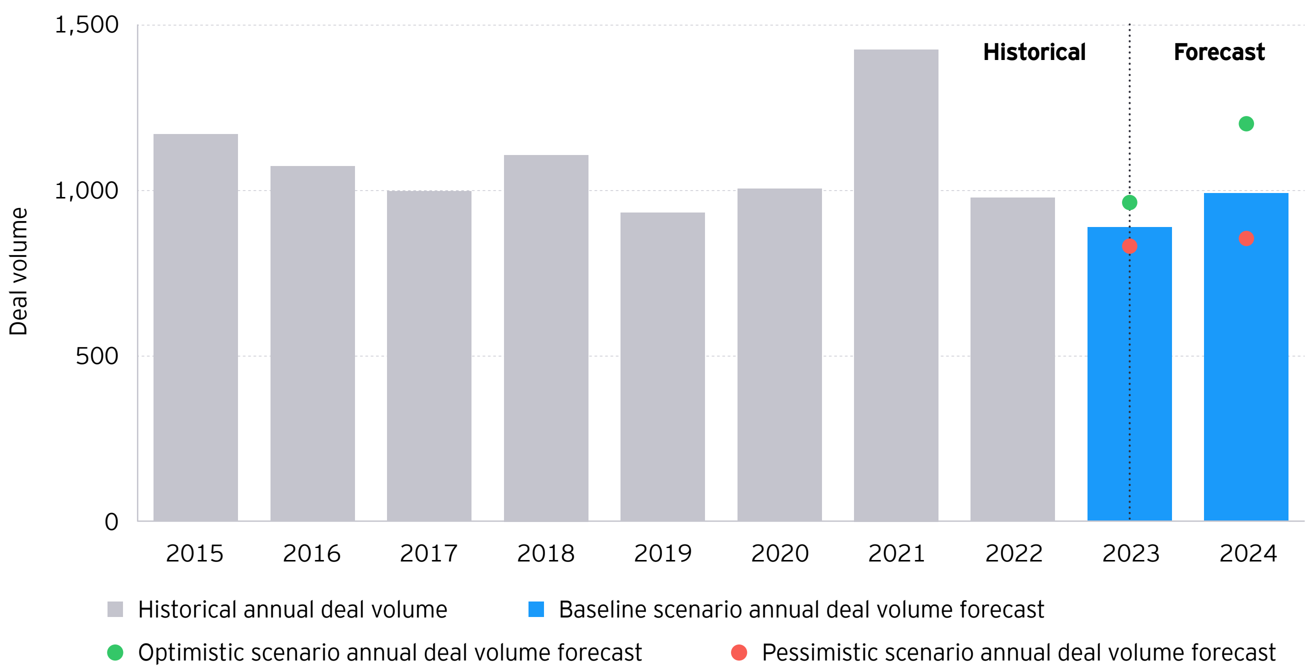
For corporate M&A, the EY-Parthenon Deal Barometer expects deal volume to gradually pick up through 2024 (Figure 2) so that deal volume rises 12% y/y, following a 9% decline in 2023. Still, this would be 30% lower than the 2021 peak.

Historically, corporate M&A deal volumes (for deals over $100 million) have been relatively stable around 1,000 deals per annum. Like the PE deal space, the pandemic resulted in a large positive shock for deal volumes, registering an impressive jump of more than 40% in 2021. The Deal Barometer largely anticipates a return to the pre-pandemic levels of activity, with the number of deals in 2024 only about 2% below the average number of deals in 2017–19.

In our optimistic scenario, our Deal Barometer anticipates more forceful recovery for 2024, with the total number of deals increasing 31%. In the downside scenario, M&A activity is expected to show a muted recovery with only 1% growth in 2024.

Figure 2: US corporate M&A deal volume

Our baseline outlook suggests corporate deal volume will finish 2023 ~9% below last year before seeing a ~12% recovery in 2024.



Year-over-year growth	2016	2017	2018	2019	2020	2021	2022	2023F	2024F
Baseline	-8%	-7%	11%	-16%	8%	42%	-31%	-9%	12%
Optimistic								-6%	31%
Pessimistic								-13%	1%

05 Private equity market perspective

Deal types are expanding, with carve-outs increasing.

Today's PE market is seeing a broader array of deal types, in contrast to the first half of this year, which was characterized by a very narrow focus on take-privates and add-on transactions. Recent months, for example, have seen several large carve-outs from corporate parents seeking to divest non-core or orphan assets.

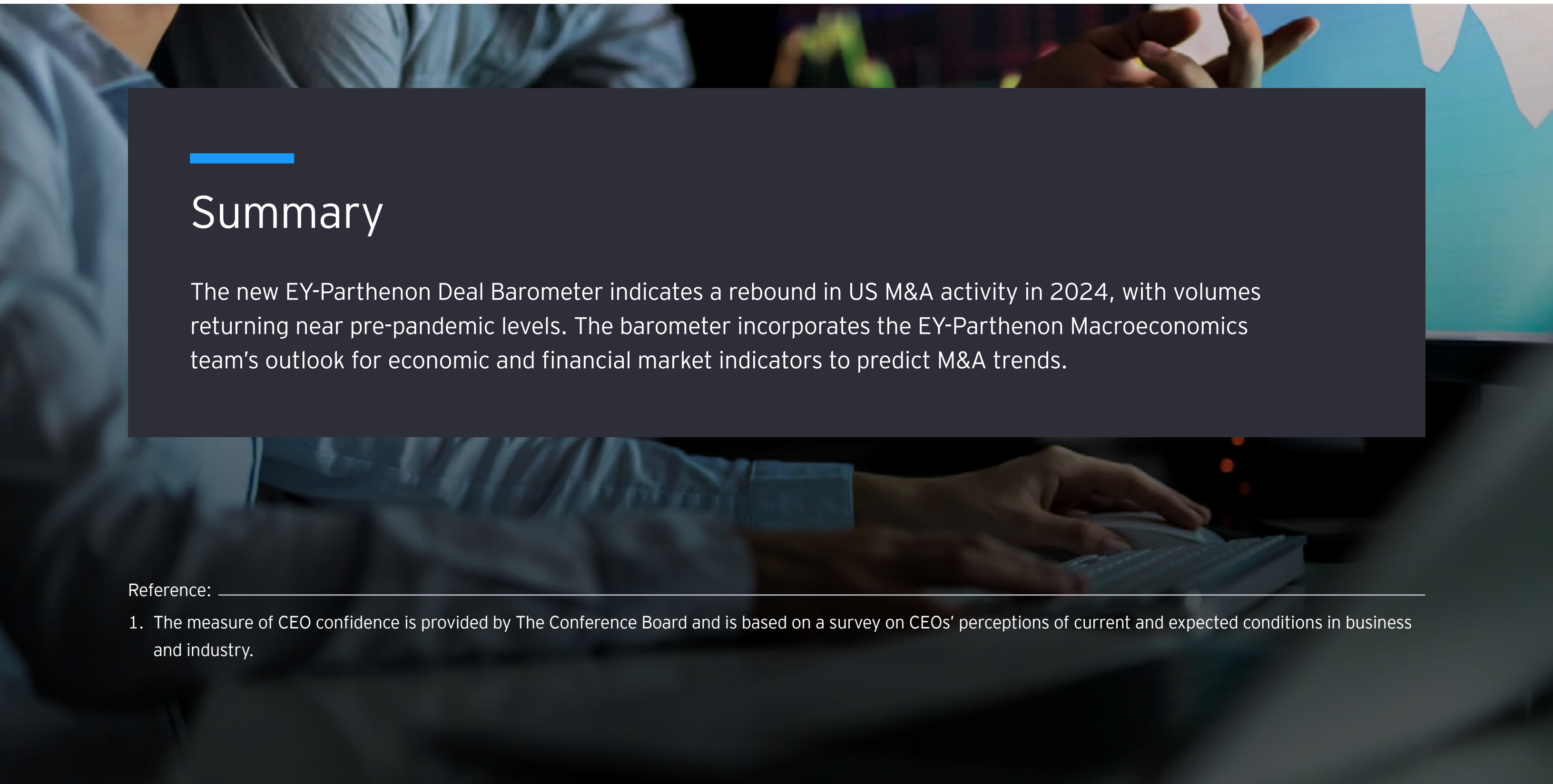
Of the top 20 deals announced in Q3, approximately a third were carve-outs, with an aggregate value of nearly $25 billion (in contrast, Q1 was just 5% carve-outs). For PE firms, especially the largest funds, these deals can be competitive differentiators, providing opportunities for firms to leverage their scale and their operational expertise to drive value.

Exit markets have shown similar signs of recovery in recent months, albeit at a slightly slower pace than acquisitions. In the third quarter of this year, PE firms announced 68 exits via M&A, up from 47 in the first quarter of the year and up from 57 in Q2.

From a sector perspective, technology continues to be a key area of focus, accounting for nearly one-third of PE activity by value over the last 12 months, up from 26% over the preceding 12 months. Investors remain attracted to the industry's long-term secular growth story, its relative resilience in the face of macro headwinds, and the growing integration of technology in sectors such as health care, finance, industrials and energy.

Over the last 12 months, the health care sector has accounted for 10% of PE investment by value, up from just 6% over the preceding 12 months — that focus is expected to accelerate.

For firms' existing portfolios of assets, one of the primary consequences of extended hold periods is imperative to optimize operational value-add to offset longer ownership periods. Even for new acquisitions, with many assets continuing to be "priced to perfection," there is little wiggle room for suboptimal execution.



Summary

The new EY-Parthenon Deal Barometer indicates a rebound in US M&A activity in 2024, with volumes returning near pre-pandemic levels. The barometer incorporates the EY-Parthenon Macroeconomics team's outlook for economic and financial market indicators to predict M&A trends.

Reference:

1. The measure of CEO confidence is provided by The Conference Board and is based on a survey on CEOs' perceptions of current and expected conditions in business and industry.

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