

M&A Market Outlook for 2016: Where do we go from here?



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Timing is everything as the old saw goes. While that specific combination of words is heard more times than one can legitimately count, its basic application in view of M&A market cycles is about as appropriate as it gets. Unsurprisingly, 2015 landed as a record

year for mergers and acquisitions, with the aggregate U.S. transaction dollar volume topping \$2 trillion for the first time in recorded history. Ample private equity capital, favorable debt markets and a healthy appetite amongst corporate buyers seeking to boost sluggish organic growth fueled the market into uncharted territory. As is the case every January, the question on the minds of business owners and the deal making community alike is: where do we go from here?

As the technicians pull out the charts in search of recognizable patterns, the last several market cycles do indeed flash some discernible commonality – past M&A market tops have closely approximated stock market peaks, followed shortly thereafter by a meaningful and sustained downward trend. Whereas it's virtually impossible to credibly call a market top in real-time, it should be noted, depending on how the



cycle is measured, that the M&A market is in the sixth year of an uptrend – and the history books suggest that's just about the outside limit of standard duration.

Before breaking out the Kleenex, it would serve everyone well to take a deeper look into the DNA of the past couple of cycles to better determine if history is likely to repeat, or whether an evolved "cycle phase" is occurring at this juncture. It's most likely the latter this time around. In short, the 1999-2000 peak was a clear function of a disassociation from reality and a full-fledged ignorance of value fundamentals that manifested in the tech meltdown. The

2007 M&A peak was fueled by an evaporation of underwriting discipline that rendered every deal financeable at staggering leverage levels. Both of those cycle endpoints were classically defined bubbles that inevitably burst, and in each case they came at the end of a sustained cycle of business investment and GDP growth that materially outstripped the tepid recovery of the 2010s.

This time around, there isn't some form of speculative mania at the market helm, but rather a distinct feel that current stage volume is being driven more by the fundamental needs of acquirers. The larger

corporates are under constant assault by shareholders and activists to grow revenues and accelerate earnings, and to accomplish such by finding more productive uses of high balance sheet cash levels than simply sitting on Treasury yields. In the capital markets, the vastly expanded, significantly more competitive, private equity universe finds itself under increasing pressure to deploy roughly \$600 billion of unlevered equity capital lest limited partners (LPs) become anxious about the velocity backing their fund commitments. Mix in a friendly lender universe that's hungry for yield and experiencing a competitive boom of its own (e.g., private debt funds and a recent boom in the formation of Business Development Companies), and it becomes readily evident why 2015 was a banner year of activity.

All things considered, 2016 does not represent the immediate prelude of a bursting bubble but rather a tightening in the financing markets with increasing market uncertainty (geopolitical, political and bull market duration), suggesting that a downturn is likely on the horizon. When the cycle softens, the combination of dampened financial fundamentals and multiple compressions mean that it could be two to three years before a seller's realizable valuation works back to today's par. As such, owners that are seriously considering a sale or a liquidity event must prepare an actionable plan that enables a 2016 market entry, as the cycle odds will inevitably come to roost sooner than any of us would prefer.