Halfway through 2017: With no dramatic shifts, deals on track for a steady year

PwC's Deals mid-year review and outlook

So far, 2017 isn't quite the year many deal forecasters were expecting. But at the midway point, it looks on track for a finish that won't leave dealmakers gritting their teeth.

A deals market that had a bullish start in 2017 — anticipating what a new, business-friendly government administration might do — has calmed along with the stock market. But deal volumes are up over 2016, suggesting the fundamentals are in good shape.

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Businesses appear to be giving a vote of confidence to an economy growing steadily, if not spectacularly. They're still striking deals and taking long-term opportunities. They're getting on with growth and likely won't be knocked off their stride by turbulence in Washington. Indeed, the early thoughts of "we'll see what happens" with new policies and regulations may be giving way to "we'll believe it when we see it."

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Money is still cheap and plentiful, with private equity firms and corporate balance sheets having plenty of dry powder at their disposal. And the intervals between rate rises might well be longer than seemed likely at the start of the year. Boards might also want to signal strength to shareholders with an acquisition.

So what can we expect for the rest of the year?

Political influence wanes—for now

It was going to be the year government put fresh wind in the sails of the deals market. It now seems more likely that the market will run on its own momentum for at least the near future.

Certainly, measures like the widely-touted tax reforms, including the prospect of a tax holiday for cash repatriated from overseas, would likely put a spring in the market's step. In theory, businesses with more available capital could seize the opportunity to grow through M&A.

While Republicans' commitment to delivering on their tax reform promise remains strong, the question for now is when it will happen. The long-running debate over the administration's healthcare overhaul suggests it could take longer than many anticipated to move on its tax reform agenda. The issue now is whether reform can be completed this year or if the effort will carry over into early 2018.

The lack of political momentum has confounded expectations, and that could partly explain the recent dip in jobs growth. May's unemployment rate of 4.3% was a 16-year low, according to US Labor Department data. But the economy added only 138,000 jobs — about 25% lower than expected.[1] Data like this could have more of an impact on deals than political machinations.

1 US Department of Labor, Bureau of Labor Statistics, The Employment Situation — May 2017, https://www.bls.gov/news.release/pdf/empsit.pdf

Slow progress for budget proposals

The administration's budget proposals — forecast at the turn of the year to be another adrenaline shot for the economy — also may not pass quickly. That means any impact on sectors like defense, energy and technology also will have to wait.

It's interesting to note how many measures the minority Democrats were able to include in the bill for this fiscal year. This could indicate the administration's influence won't be as pervasive as many expected, despite a Republican majority in both houses of Congress.

The same goes for the ramifications of the US pulling out of the Paris climate change deal. Not only will withdrawal take a few years, but signs are that some states, cities and businesses may take a unilateral path by working with other nations to support the deal. That's another sign of the limits of political influence.

Easing up on regulation?

But other signals look clearer. Pending megadeals — deals at least $5 billion in value — could suggest more political tolerance for transactions that previously may have raised concerns about competition. That would fit the administration's broadly anti-regulation stance.

So would its stance on the Dodd-Frank banking regulations. The government says it's ready to review a regime seen by some as a barrier to growth. But once again, such a controversial change is bound to be a long time coming.

Deals keep pace with 2016—except at the top end

So far, the year's M&A activity seems broadly in step with the same period in 2016, though business has been somewhat brisker. While deal value is down from a year ago, volume is up by 12%. That's a good signal of the market's health, especially when you consider some of the value loss is from a decline in megadeals.

Deal volume up by
12%
year-over-year

Industry highlights: Tech shares the lead, and disruption is still a theme to watch

Sector activity is also broadly in line with the same period in 2016. Technology continues to lead the way and is joined by consumer. As we noted in our Q1 industry analysis, established businesses are modernizing through technology-focused deals, making traditional industry boundaries blurry and unconventional.

Tech and consumer have accounted for about one-third of deal activity, while industrial products and financial services made up about one-fourth of deals — similar to the same period last year. Eyes will be peeled for any sign that mid-June's dip in the Nasdaq technology index is anything more than profit-taking.

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Inbound US deal prospects grow

With a stable economy and currency, the US will likely continue to attract overseas investors. And odd as it might seem, "buy American, hire American" signals from Washington could boost interest. Buyers might see taking a stake in the world's largest consumer market as insurance against isolationism.

In PwC's *Global CEO Survey*, four out of 10 CEOs said their companies are targeting the US for their growth prospects. That was reflected in the 6% rise in inbound deal volume through Q1 2017. A few months later, the pace has picked up, with year-over-year volume up 10% through May. This could be a sign that overseas businesses are looking to the US to compensate for uncertainties in markets such as China, South Korea and Russia, where economic prospects aren't as stable.

The US is rich in the desired tech start-ups that some traditional businesses need to reinvent themselves. Not surprisingly, tech deals make up nearly a quarter of inbound deals so far this year. Their attractiveness seems unlikely to tail off despite the high valuations that a relatively strong dollar naturally creates.

Could more stability make Europe more attractive?

Outbound deals are lagging by comparison, with volume down 9% over 2016. But here, too, prospects have improved. Defeats for anti-European Union parties in the Netherlands and France appear to have restored some political stability. Could this make Europe a more attractive market for US outbound investment?

Set against this is the still-unknown full impact of Brexit. A "soft" version of the separation seems more likely after the recent UK election, and dealmakers undoubtedly will have their eyes on this as Brexit negotiations unfold.

Outbound deal volume down
9%
year-over-year

Divestitures could be the deals to watch

Beyond M&A, other deal activity can offer signs of life in the economy. Divestitures year-to-date are up 9% from 2016, with virtually no change in value.

The activity could signal many things — companies refocusing activities, raising capital for fresh acquisitions or spinning off successful units. More sell-offs could be a sign of more economic activity, especially in sectors such as industrial products and consumer, which accounted for more than one-third of all divestiture activity so far this year. Divesting underperforming business units is also a tried-and-true tactic for fending off activist shareholders, which have gained notoriety in recent years for high-profile campaigns.

Private equity remains steady, for now

Despite substantial dry powder on the balance sheets, private equity deal activity through May hovered at the same volume as last year, with a 14% dip in value. Telecommunications and media, consumer and real estate deals combined made up over 60% of the value of PE acquisitions so far this year. In terms of volume, technology, consumer and industrial products led the way, reflecting 24%, 15% and 15% of all PE deals, respectively.

IPOs up and well-positioned for the year

Meanwhile, IPO activity is nearly double what it was for the same period in 2016. The 69 offerings, which raised $20.7 billion, are just shy of the proceeds for all of last year.

But while IPOs are well ahead of 2016, they still trail every other year since 2010. That's partly due to a slowdown in pharma and life sciences. Also, uncertainty over the Affordable Care Act may have kept both healthcare issuers and investors on the sidelines.

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There were strong showings in other sectors, including technology and oil and gas, which investors see as market bellwethers. High-quality offerings contributed to a surge in the average size of deals; over 70% raised more than $100 million. Post-IPO performance also was strong, with overall returns from IPOs beating those of the major US indices.

The outlook for the second half of the year is solid, with the buy-side looking to the IPO market to produce hefty returns.

Slow but steady growth in capital markets

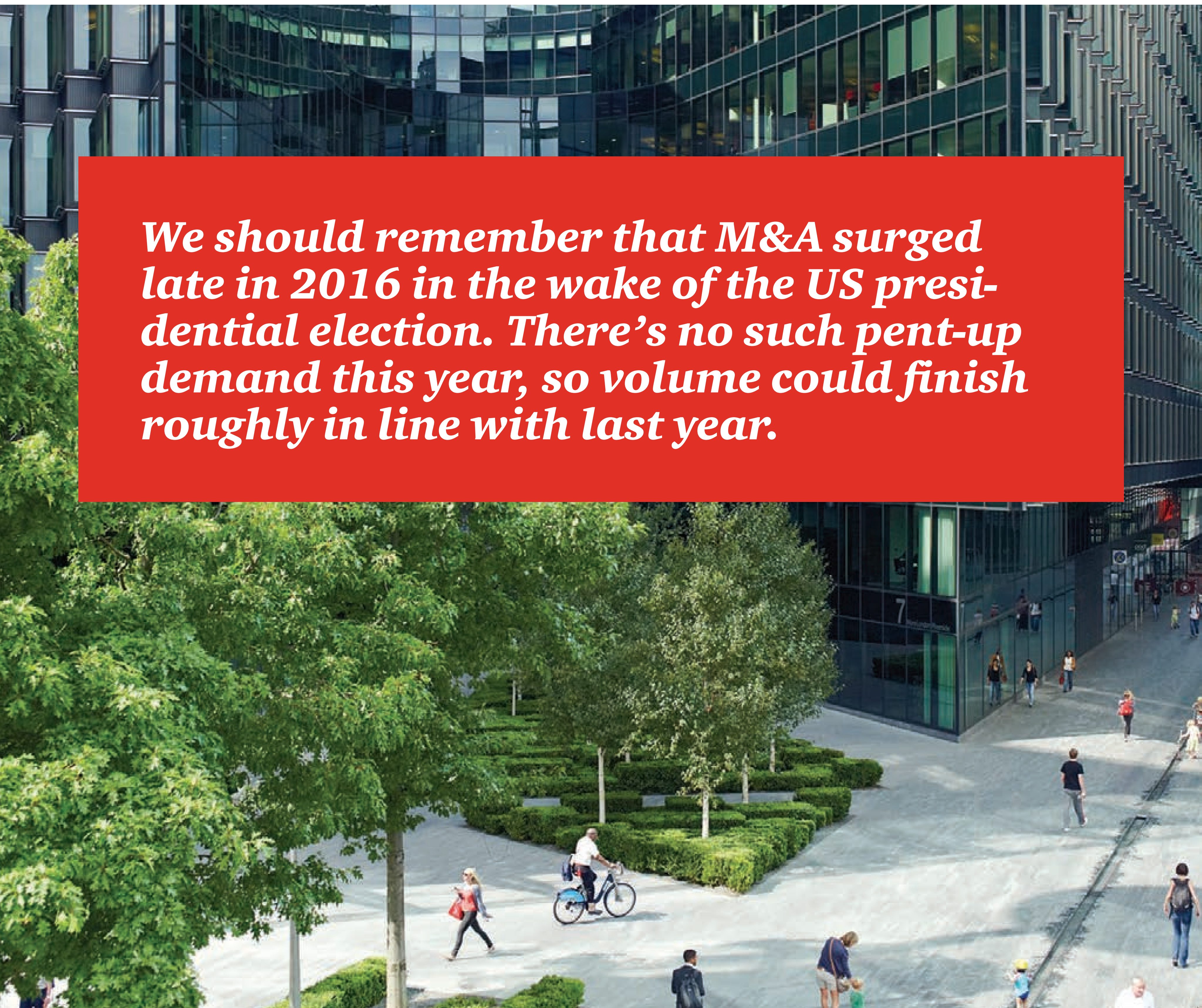
Aside from IPOs, other capital markets like follow-ons and high-yield debt were up significantly on 2016's first five months. But as with IPOs, securities issuance was down over previous years. Through May 2017, 344 follow-ons raised $66.4 billion, and 224 high-yield debt issuances raised $122.2 billion.

In contrast, US market indices kept rallying, reaching record highs through the first half of the year as volatility hit 24-year lows. Corporate earnings also grew strongly, despite Q1 GDP growth of only 1.2%. Optimism about the economy saw the Fed raise interest rates in March and again this month. If broader markets stay strong, and volatility stays low, capital markets activity will likely stay healthy as investors keep their eyes on global growth, the Fed and geopolitical events.

Steady as she goes for the rest of 2017

Based in part on performance to date and the lack of significant disruption so far in 2017, we see the deals market likely holding steady for the rest of the year. Activity has broadly mirrored 2016 so far, and it will take a large, unexpected development to blow it off course for the rest of the year.

Although volume so far outstrips last year by 12%, we should remember that M&A surged late in 2016 in the wake of the US presidential election. There's no such pent-up demand this year, so volume could finish roughly in line with last year.



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Let's talk

For a deeper discussion on deal strategy and trends,
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