SPECIAL REPORT

U.S. M&A OUTLOOK 2023

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Foreword

Welcome to Bridge Bank's U.S. M&A Outlook 2023

The mergers and acquisitions (M&A) space has seen a lot of ups and downs over the past two years. While dealmaking has changed and experienced a bit of a downturn in 2022 compared to 2021, M&A participants have shown resilience and patience to make deals at the right time.

In this report, we present expectations for 2023 based on the findings of a survey of U.S.-based senior strategic buyers and corporate dealmakers across various industries. We also share our outlook on the trends that will drive M&A through the end of 2023.

On behalf of Bridge Bank, Euromoney Group structured and executed an online survey of 152 senior finance, M&A and legal executives from U.S.-based companies across industries and varying sizes (annual revenue), seeking their insight on the subject of M&A. The survey was conducted during November 2022.

The Bridge Bank Business Escrow Services team is a specialized, trusted resource for strategic buyers, leading law firms, exiting companies and other deal constituents. Clients choose the group for its in-depth experience, combined with expert, personalized service and innovative product features and technology.

Bridge Bank is part of Western Alliance Bank (NYSE: WAL), Member FDIC, which is one of the country's top-performing financial institutions. With more than $69 billion in assets, business clients benefit from a full spectrum of tailored banking solutions and outstanding service delivered by industry experts who put customers first. Major accolades include being ranked #1 top-performing large bank with assets greater than $50 billion in 2021 by both American Banker and Bank Director.

> **Western Alliance Bank ranked #1 top-performing large bank with assets greater than $50 billion in 2021 by both American Banker and Bank Director.**

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Executive Summary & Key Findings

Despite a challenging dealmaking environment during the past year, there were strong signs of resilience in the U.S. M&A market, supporting optimism that activity levels could rebound in 2023.

This is the main sentiment of 152 senior U.S.-based dealmakers – from chief executives and financial officers to heads of M&A and corporate development – who we surveyed for their views on the key trends, risk factors and general temperament in the U.S. M&A market.

Lingering concerns around economic growth and the impact of elevated energy prices, inflation, rising interest rates and financing costs are dampening their optimism. But overall, dealmakers appear hopeful as they assess the new landscape for opportunities. Together with this, survey respondents said that they are becoming more aware of the potential for activist investors to impact their M&A strategy, with some putting in place defense strategies to combat any potential campaign against their company.

In addition, and given the tougher dealmaking context, the survey insight shows a healthy appetite for greater financial protection in deals, including interest in using representations and warranties (R&W) insurance. As dealmaking becomes ever-more digitally advanced, the use of technology – from artificial intelligence and machine learning to relationship mapping – is rising in the process, giving hope that certain areas such as deal sourcing to due diligence can be further transformed.

Digital payment innovation is also impacting how companies finance deals. Notably, at the time that the survey was run, dealmakers indicated that they would give serious consideration to using digital currencies in full or in part to pay for acquisitions.

> **"Given the tougher dealmaking context, the survey insight shows a healthy appetite for greater financial protection in deals."**

- **Robust M&A appetite**
  68% of respondents anticipate actively engaging in domestic M&A during 2023
- **Deal types in focus**
  Structurally, 47% of respondents who plan to actively pursue M&A are targeting mergers. Some 40% of respondents are seeking medium-sized, transitional transactions as opposed to only 27% of respondents seeking large-sized, transformational deals
- **Areas of concern**
  45% said commodity and energy costs is the issue of most concern to their M&A plans, followed by U.S. economic growth (40%) and rising rates and financing costs (36%)
- **Activism on the radar**
  69% of dealmakers responded that they are either conscious or are very conscious of investor activism
- **Defense strategy in play**
  47% said they have an activism defense strategy in place, including frequent business vulnerability testing and shareholder reviews
- **M&A tech upgrade**
  74% said AI is being used in their dealmaking process, followed by relationship mapping (64%) and machine learning technologies (50%)
- **Tech transformation**
  41% believe deal sourcing and 39% believe M&A strategy are areas where technology could be most transformative
- **Alternative payment methods**
  At the time surveyed, 49% believed it was possible to use digital currencies to pay for acquisitions in full or in part and indicated that their company planned to do so
- **Interest in insurance**
  A combined 50% of companies said they are very interested in representations and warranties insurance, with 11% having already used it and 39% planning to use it
- **ESG M&A lens**
  With respect to ESG considerations, 40% said a target's business ethics is the most important aspect of ESG in their M&A strategy, followed by environmental impact (32%) and diversity, equity and inclusion (26%)

2023 Outlook & Risk Factors

Domestic dealmaking sentiment in the U.S. is strong going into 2023, potentially leading to a rebound in M&A activity after a year when volumes were hit hard by several macro risks.

The M&A downturn mirrored a global trend as companies pulled back from dealmaking amid heightened geopolitical risk, economic uncertainty, inflation, rising interest rates and consequent bouts of financial market volatility. The net effect drove U.S. M&A volumes down 43% to $1.53 trillion in 2022 compared to 2021, with similarly steep falls recorded in European and Asia-Pacific markets.

However, despite many of these risks lingering, sentiment among dealmakers in the U.S. appears broadly positive going into 2023 – 68% of respondents said they anticipate actively engaging in domestic M&A through the end of 2023, and 32% plan to actively engage in cross-border deals (see **Figure 1**). Moreover, more than three quarters of executives (77%) who responded are very confident or fairly confident in the strength of the dealmaking environment during 2023 compared to only 7% being not very confident (**Figure 2**). Such bullishness is striking, as it suggests that companies are eager to capitalize on domestic investment opportunities, and with the dollar's strength relative to other currencies, foreign acquisitions also appear attractive.

In general, such positive dealmaking sentiment is most evident among executives from companies in the technology, media, entertainment and communications industry, as well as food and beverage, healthcare and life sciences, and retail and consumer.

On the types of deals being targeted, 47% of respondents who plan to actively pursue M&A are targeting mergers. Some 40% of respondents are seeking medium-sized, transitional transactions as opposed to only 27% of respondents seeking large-sized, transformational deals (see **Figure 3**).

68%

Anticipate actively engaging in domestic M&A through the end of 2023

Figure 1
Does your company anticipate actively engaging in domestic or cross-border M&A in the next 14 months (to the end of 2023)?

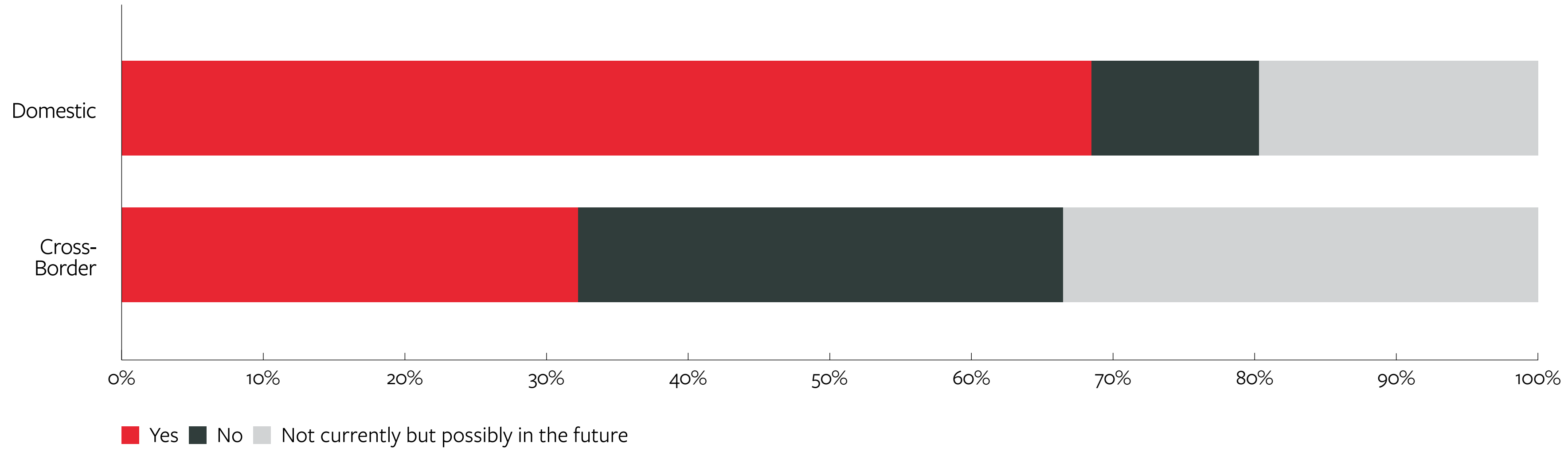


Figure 2
On a scale of 1-5, where 1 represents not at all confident and 5 is very confident, how confident are you in the strength of the dealmaking environment going into 2023?

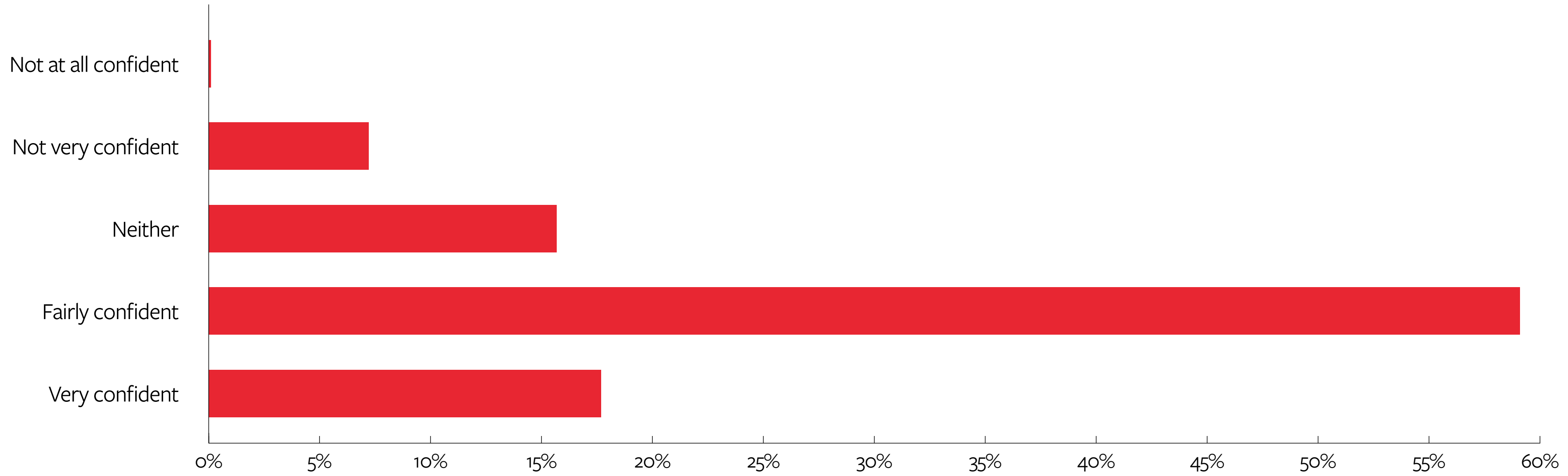
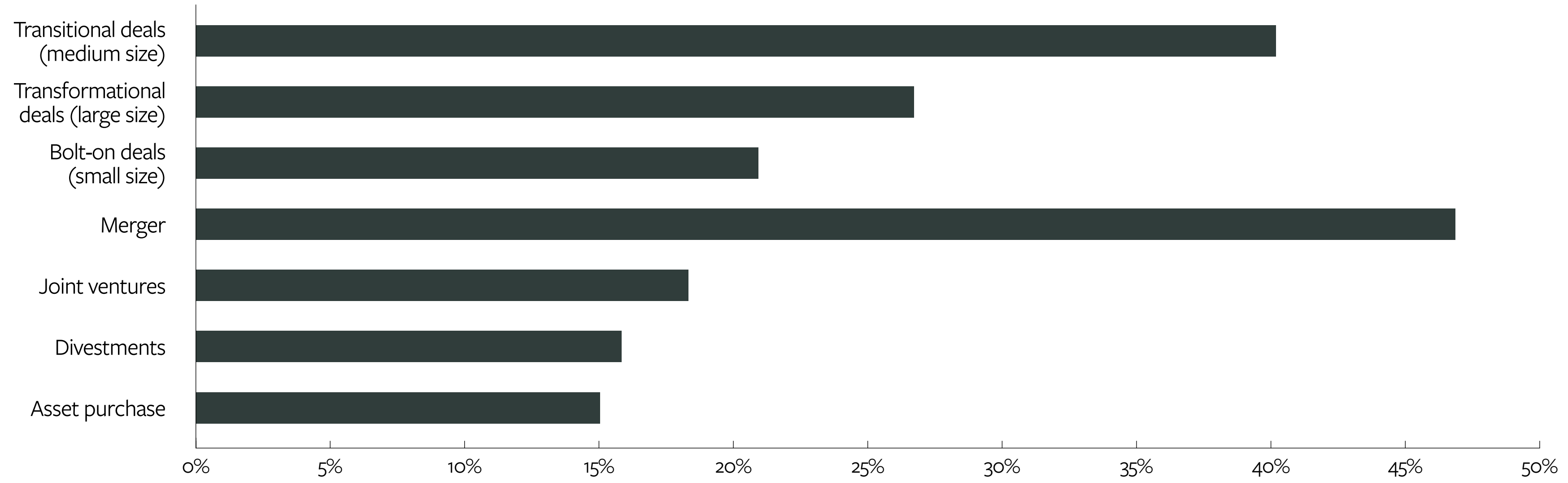


Figure 3
You said your company anticipates actively engaging in domestic and/or cross-border M&A in the next 14 months. What type of transactions?



2023 Outlook & Risk Factors

Looming Risks

While attitudes supporting M&A are robust, there is still an acute awareness around the risks to dealmaking, which impacted activity in 2022 and could persist.

"There's been a slowdown in acquisitions and people are being more thoughtful and looking at portfolio management," says an M&A executive in the medical devices industry. "I think it was more optimistic a year ago that some of these things [i.e. supply chain disruption and the pandemic's impact] could come to an end soon. Now these things are seen as longer-term problems."

High commodity and energy costs top the list, with 45% of respondents saying they are most concerned about these costs impacting their dealmaking plans. U.S. economic growth was identified by 40% of respondents as an ongoing consideration, with 36% of respondents indicating that rising rates and financing costs are concerns (see **Figure 4**). Indeed, 32% of the executives surveyed said they do not anticipate actively engaging in M&A during the next year, and cited the main reasons (see **Figure 5**) as: continued uncertainty around market conditions (47%); economic uncertainty (33%); a primary focus on organic growth (32%); asset valuations (30%) and sub-optimal financing conditions (27%).

As interest rates rise, many companies find deals much less attractive due to increased financing costs. But not all companies agree: "In my company, we don't rely on borrowed capital, so that makes things much easier," says one M&A executive. While M&A activity is unlikely to rise quickly to the levels seen in recent years, dealmakers hope that markets settle down and calmer conditions prevail going forward. Predictability tends to encourage M&A and firms will likely be more confident in moving forward if the road ahead is clear.

Those with sights on domestic dealmaking will be particularly focused on how quickly inflation can be brought under control and interest rates settle, which will allow planning to be conducted with more confidence.

> **"High commodity and energy costs top the list, with 45% of respondents saying they are most concerned about these costs impacting their dealmaking plans."**

Figure 4
Which of the following issues are you most concerned about impacting your M&A plans?

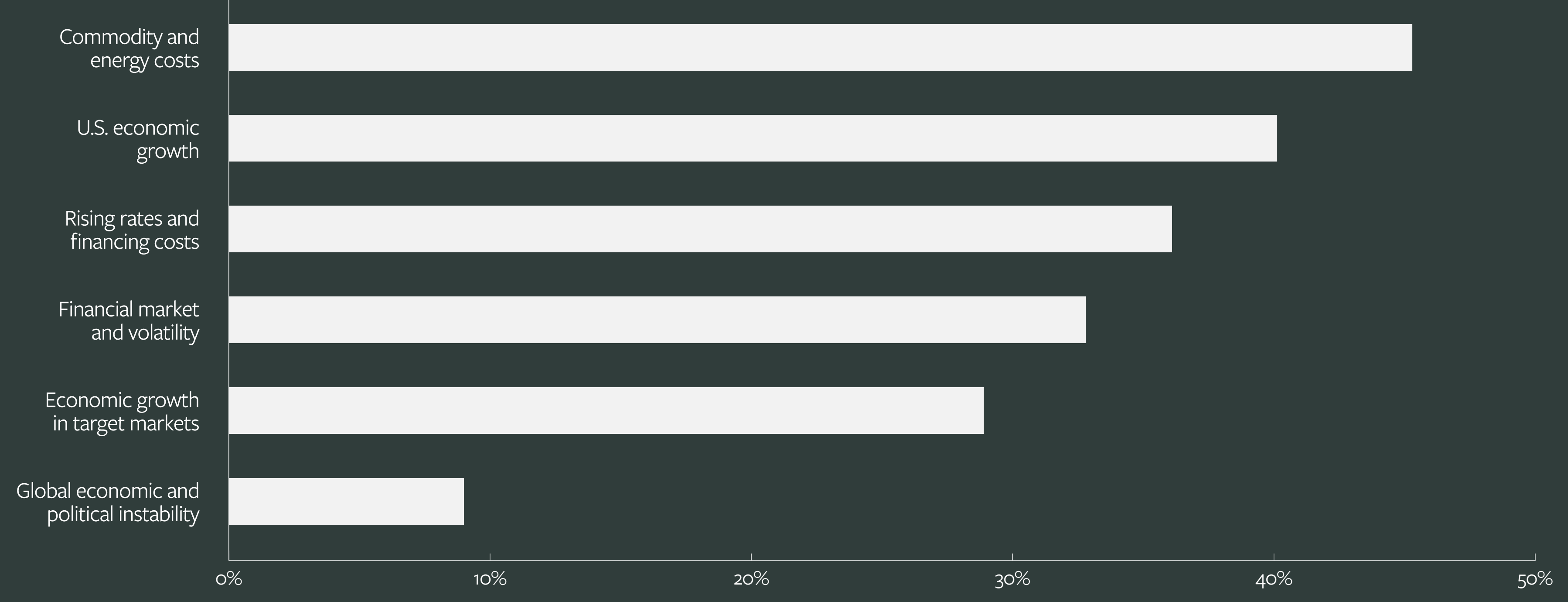
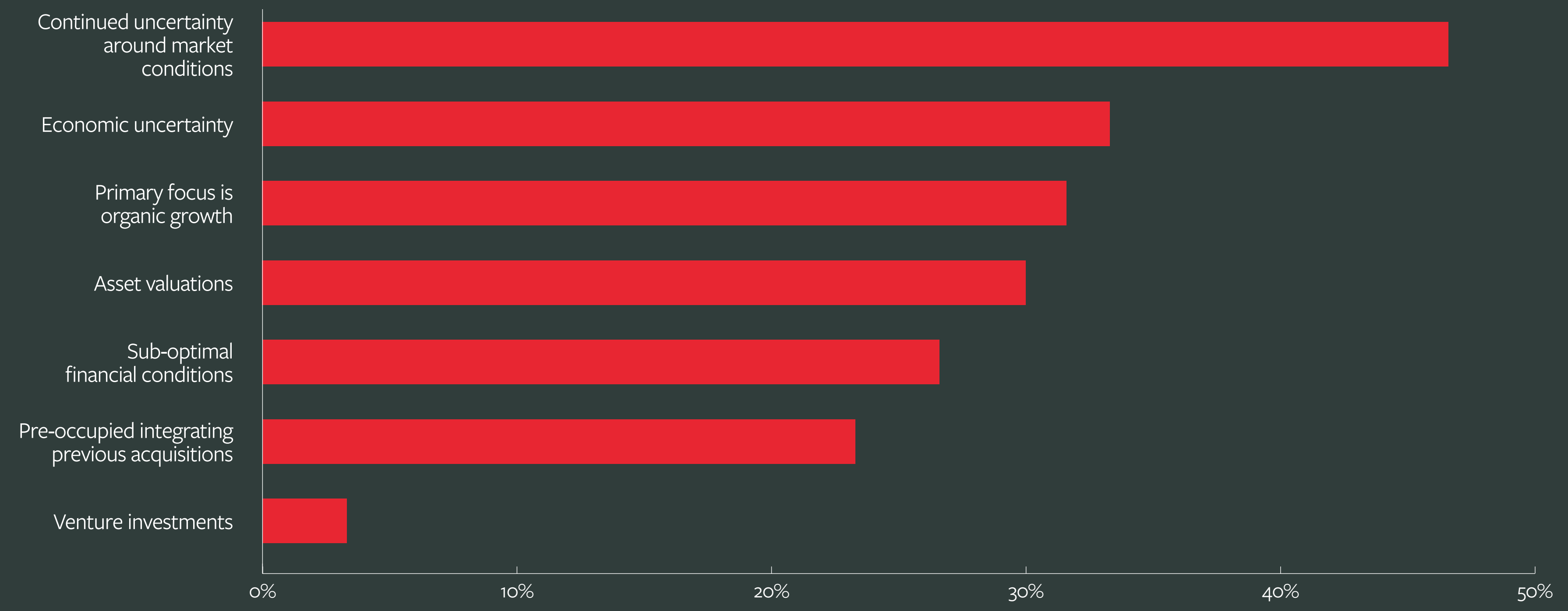


Figure 5
You said your company does not anticipate actively engaging in domestic and/or cross-border M&A in the next 14 months. What reason best describes why?



Market Trends & Developments

The nature of the M&A landscape is constantly changing. Trends that have gained prominence in the last few years include investor activism, environmental, social and governance (ESG) considerations, and representations and warranties (R&W) insurance.

Investor activism growing

The increased awareness of investor activism was evidenced in the survey, which showed that 55% of respondents were conscious of investor activism as an area of concern and 14% very conscious, indicating that it was an area they monitor (see Figure 6).

To that end, 47% say they have a defense strategy in place, while 35% said they do not but are planning to create one (see **Figure 7**). The top actions taken as part of this strategy (see **Figure 8**) include: a general business and strategy vulnerability review (60%) and a frequent review of the shareholder base (53%).

In terms of activist impact on deals, the survey revealed that transactions where activists are involved result in: deal covenants being impacted (49%); deals being re-priced (38%); deal closing conditions being impacted (37%); and deals being delayed (35%).

Given that disgruntled shareholders have found more of a voice in modern companies, ensuring their support before moving ahead with a major M&A transaction is now considered prudent.

The costs of ignoring shareholder sentiment can be high and heading it off at an early stage is likely to benefit companies as they proceed into the deal process.

55%

of respondents were conscious of investor activism as an area of concern

Figure 6
How conscious are you about investor activism?

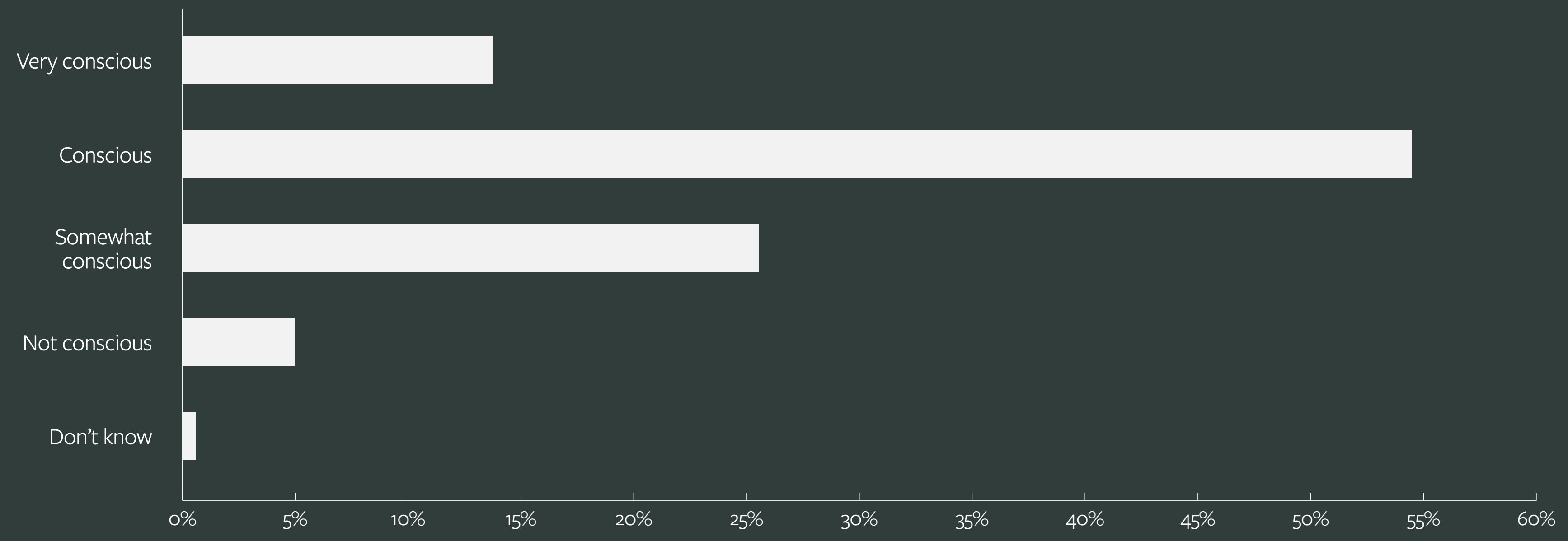


Figure 7
Does your company have a defense strategy in place should an activist investor launch a campaign against you?

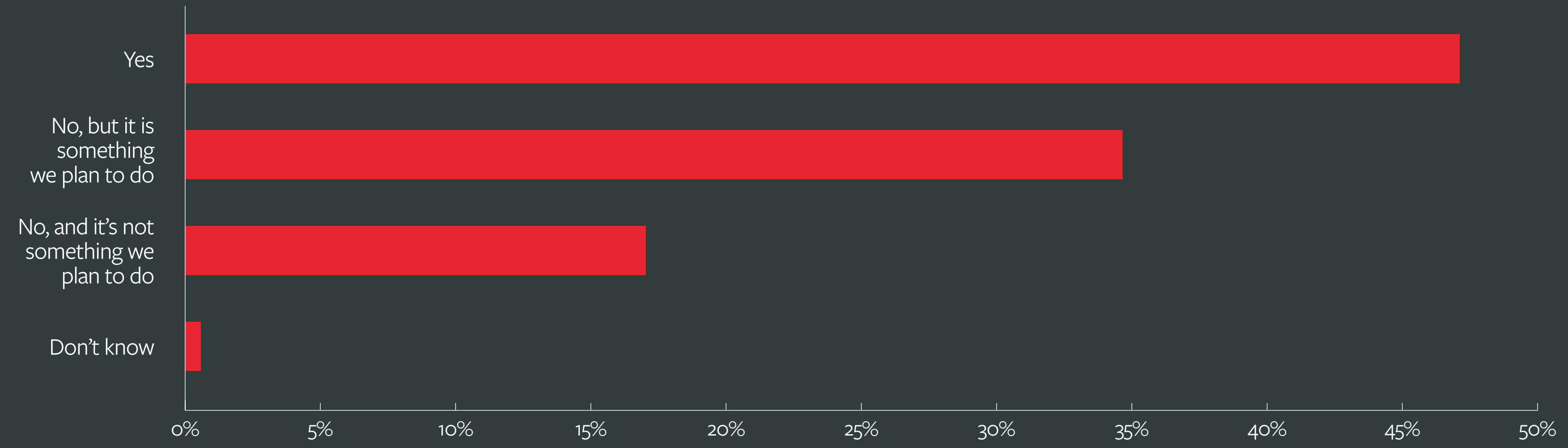
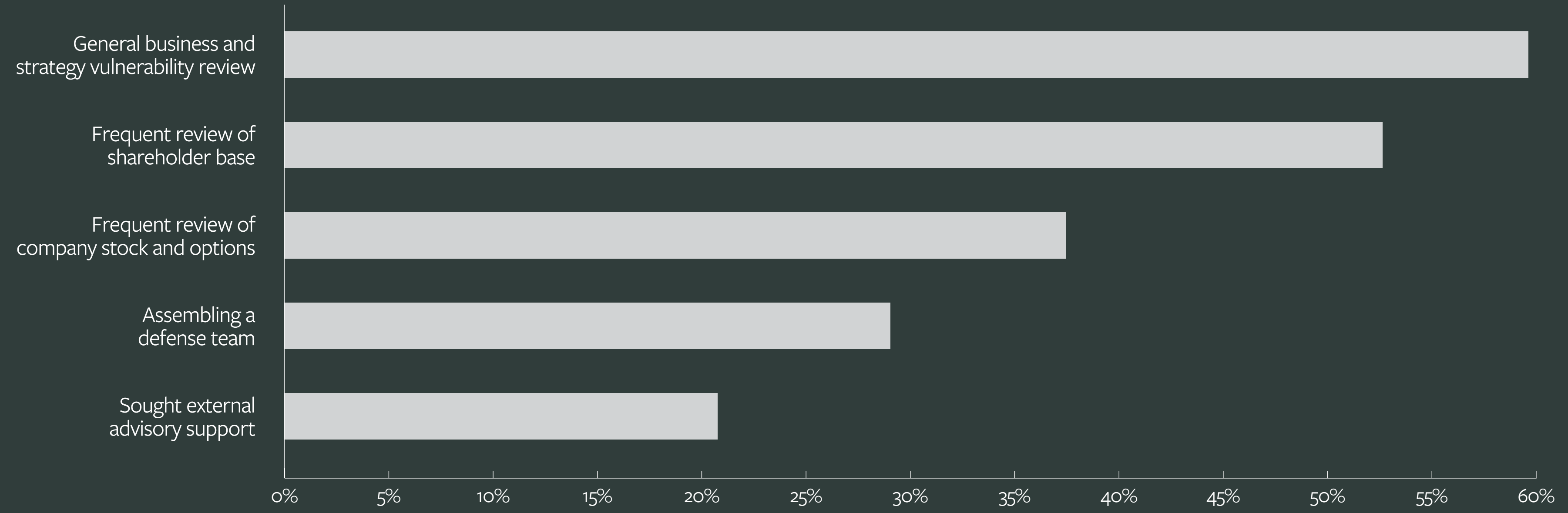


Figure 8
Which of the following measures have or are being undertaken?



Market Trends & Developments

ESG lens in M&A

The rise of ESG considerations has been one of the most significant changes in the global business environment in recent years as companies are increasingly judged for the impact they have on society as a whole and not just on profitability alone.

The implementation of sophisticated ESG measurement criteria means companies must take their social responsibilities seriously and now find themselves being held accountable by third parties. This new atmosphere is becoming a more important factor in dealmaking as some companies assess targets based on ESG initiatives.

According to the survey, respondents say the ESG factors (see **Figure 9**) most important in their M&A strategy are: business ethics (40%); environmental impact (32%); diversity, equity and inclusion (26%); governance (24%) and employee relations and rights (22%).

The introduction of these considerations into the M&A process marks a move away from viewing dealmaking through a predominantly financial lens. However, while ESG is increasingly important in M&A, it has not yet become an overriding consideration for dealmakers. “In our industry, ESG is one factor among many,” says one M&A executive in the medical devices industry. “We are getting more cognizant about ESG. Maybe it’s the wave of the future, but I don’t think we are there yet.”

Insurance interest

R&W insurance is another area that has risen in popularity because it allows selling shareholders to collect all or nearly all of their deal proceeds at closing. It is an insurance policy that is used in M&A to protect against losses brought about by the seller breaching the representations it makes in the acquisition agreement. This insurance can replace the traditional ‘seller’s indemnity’ and reduce or eliminate the need for certain types of escrow or holdback accounts.

The survey shows that 50% of companies are very interested in R&W insurance, with 11% of that pool having already used it and 39% planning to use it (see **Figure 10**). On the other hand, 40% of companies say they are interested but have no plans to use this type of insurance.

The main reasons R&W insurance has been used by respondents are (see **Figure 11**): the other party in the deal required it (53%); to avoid having to put money into escrow or avoid any clawback of the purchase price (44%); prudent risk management (43%) and the deal size was large enough to need it (21%). “In years past when the M&A environment was more of a sellers’ market, sellers could demand that R&W insurance be purchased as part of the deal terms as evidenced by the aforementioned 53% and 44% responses. Going forward we may see a shift if insurance carriers push back on claims,” says Alex Tsarnas, senior managing director, Bridge Bank.

According to the respondents, the main reasons why R&W insurance was not used in prior deals was because of: lack of availability from insurers (55%); having no need to use it (43%); it was too expensive (26%) and deals not being large enough to need it (25%). “We use it occasionally if we want to bolster the competitiveness of our bid,” explains one M&A executive. “It’s a consideration.”

> **“In our industry, ESG is one factor among many. We are getting more cognizant about ESG. Maybe it’s the wave of the future, but I don’t think we are there yet.”**

Figure 9
What aspects of ESG are most important to your company’s M&A strategy?

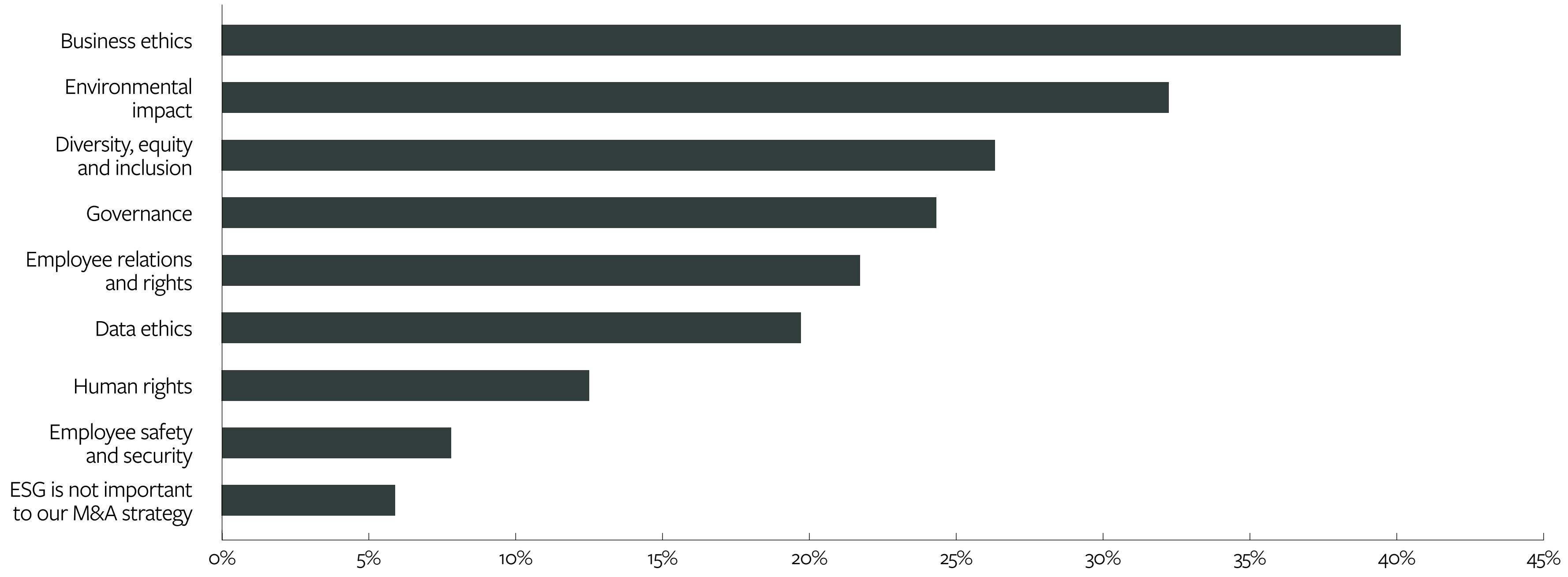


Figure 10
The use of representation and warranties (R&W) insurance is increasingly being used by companies in M&A situations.
To what extent is your company interested in this type of insurance?

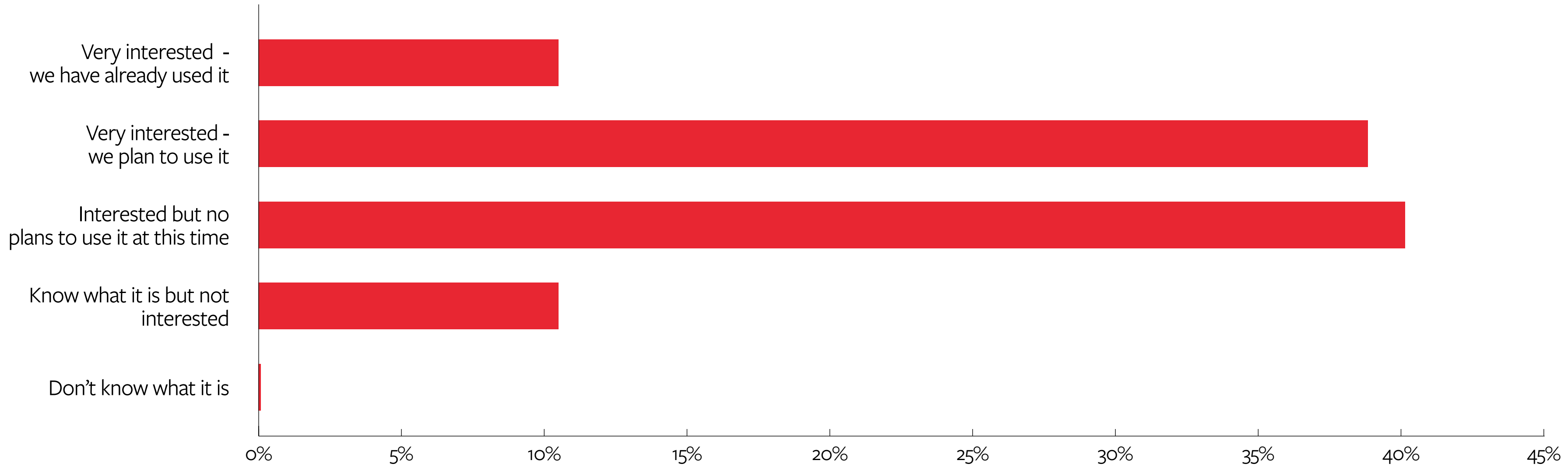
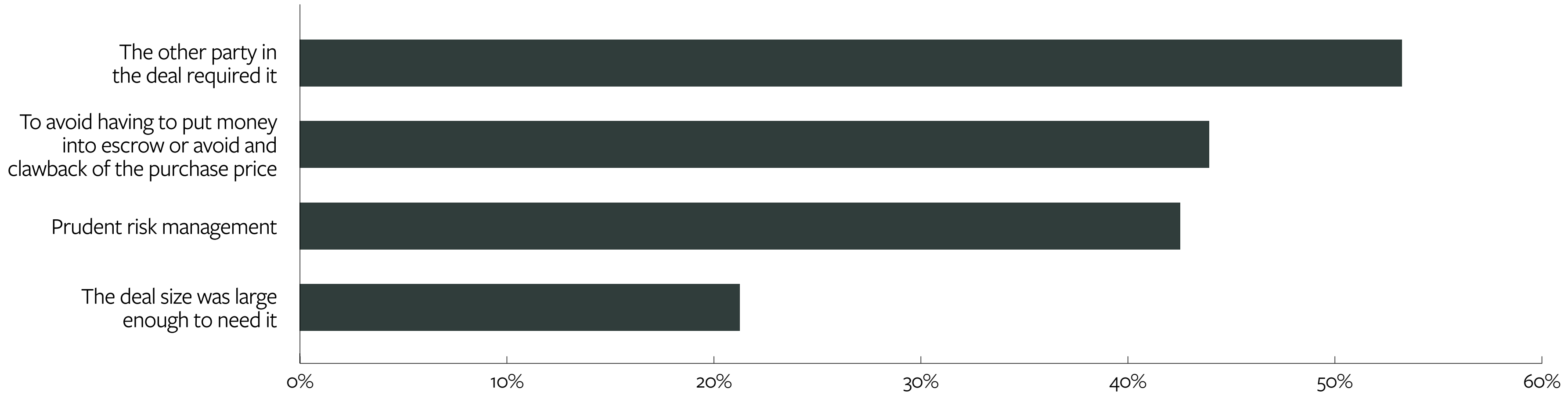


Figure 11
What reasons best describe why your comany has used R&W insurance?



Digitalizing M&A

While traditional methods of transacting are still in place, M&A practices are changing and like with most things, technology is coming to the forefront. New tools to speed-up, smooth and enrich the dealmaking process are arriving on the scene, and M&A practitioners are embracing them.

Among the technologies being embraced, artificial intelligence (74%), relationship mapping (64%) and machine learning (50%) are more common. Respondents see potential in blockchain and big data to support the M&A process as well (see **Figure 12**).

In terms of the areas of M&A where technology could be transformative, most respondents see its greatest impact on the sourcing of deals (41%) and in helping to shape M&A strategy (39%). (see **Figure 13**). A consequence of an increased reliance on technology in the M&A process is that data protection and cybersecurity have become a top priority. Moving away from the in-person elements of dealmaking has naturally left the process vulnerable to privacy breaches. Unwanted leaks during a deal have the potential to derail a carefully planned process, so taking these risks seriously is important for a successful completion.

"With respect to paying agents, clients should vet their agents to ensure this work is done by a secure financial institution required to comply with information security and privacy regulations mandated of publicly traded banks," says Heather Kelly, managing director, Bridge Bank. "It's essential to look for a solid track record of experience in those administrating the transaction and ensure that the agent understands and complies with the benchmark of the Securities Transfer Association rules and guidelines. These rules are industry best practices designed to protect the process and, at the end of the day, clients."

Respondents revealed (see **Figure 14**) that when evaluating a target company, the key due diligence focus and related precautionary measures taken around data protection and cybersecurity in transactions include: privacy due diligence (55%); vulnerability assessment and penetration testing (37%) and cyber risk assessment (33%).

The digitalization of the M&A process created a growing industry of service providers offering products such as digital data rooms and automated due diligence, but complex systems create complex problems and dealmakers must continue to adapt their processes as the technology advances.

Figure 12
Which of the following technology areas are you currently using in the M&A process, or do you believe has potential to be used by dealmakers?

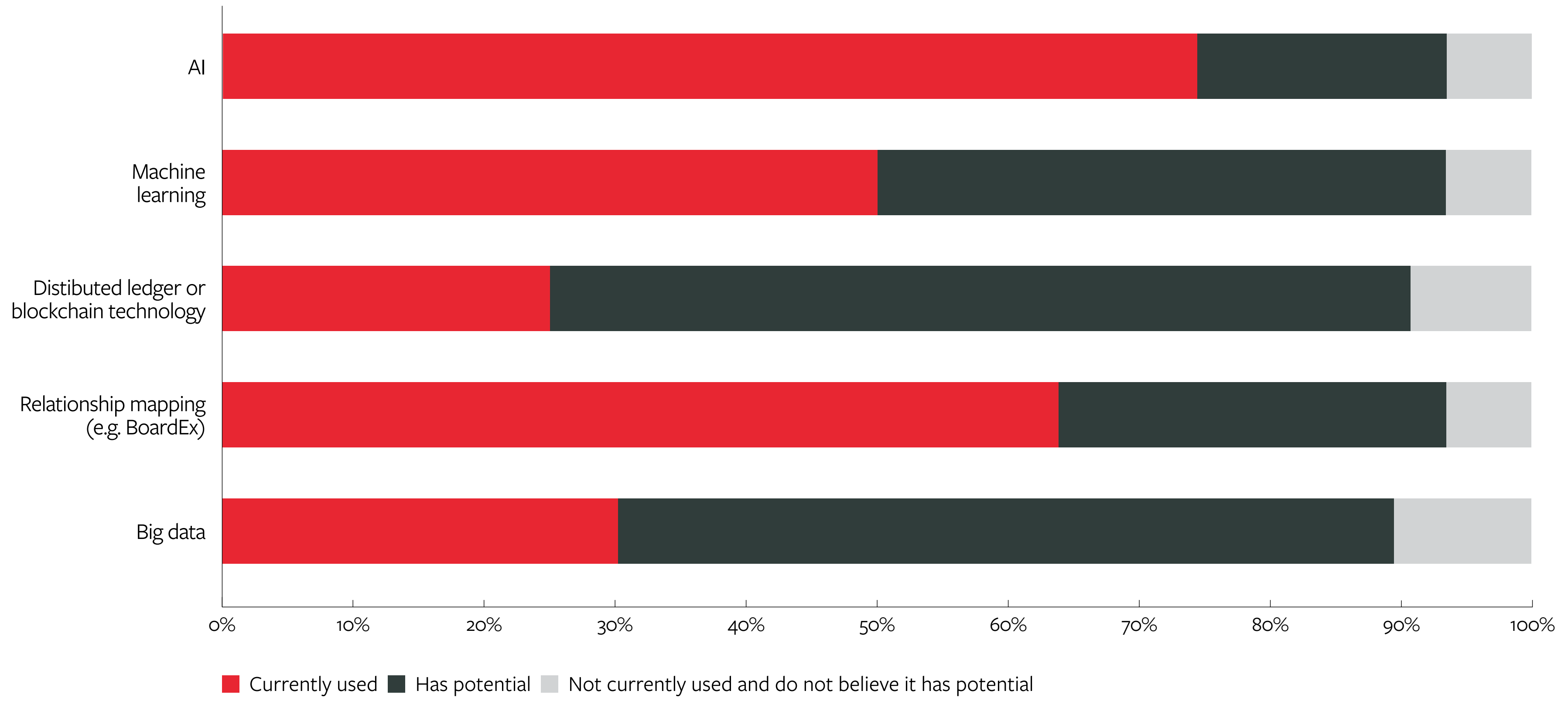


Figure 13
Which parts of the M&A process do you believe could be transformed most by the use of these technologies?

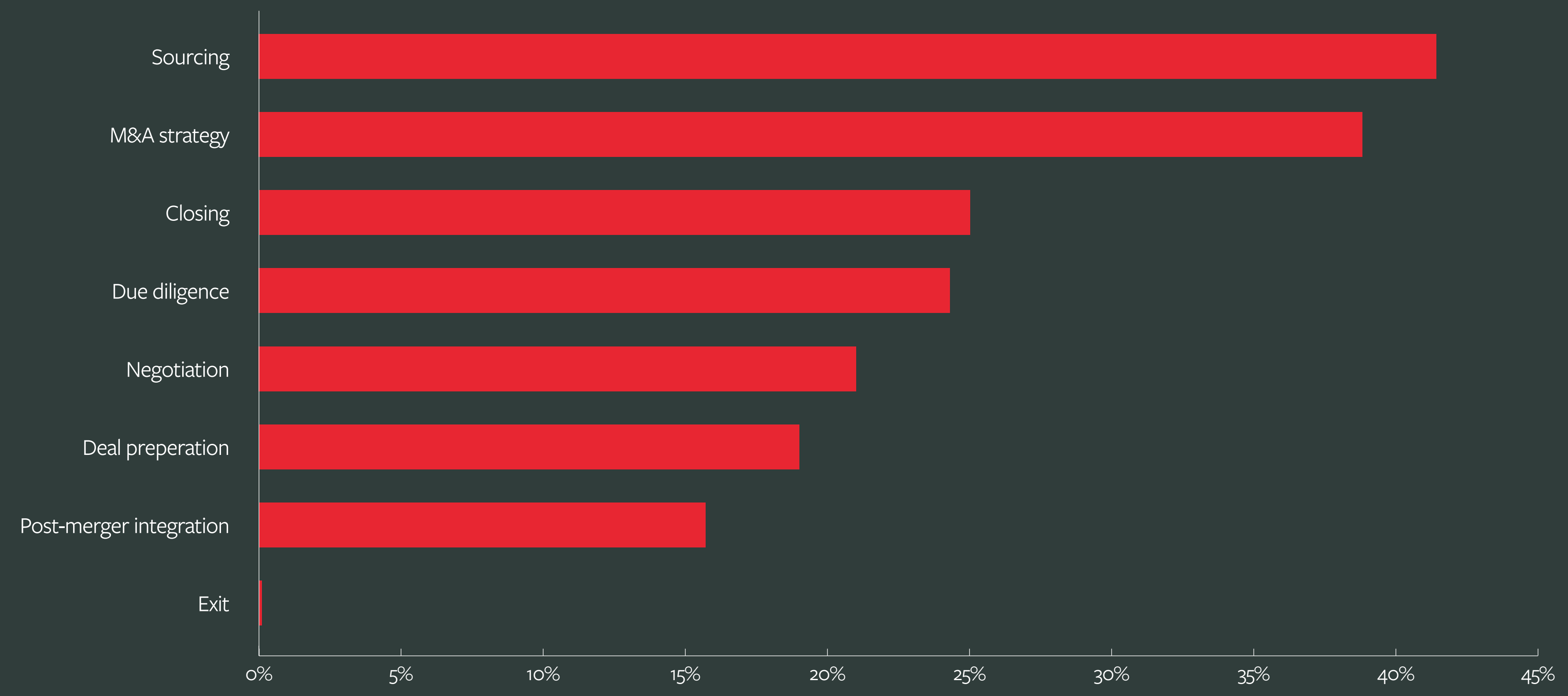
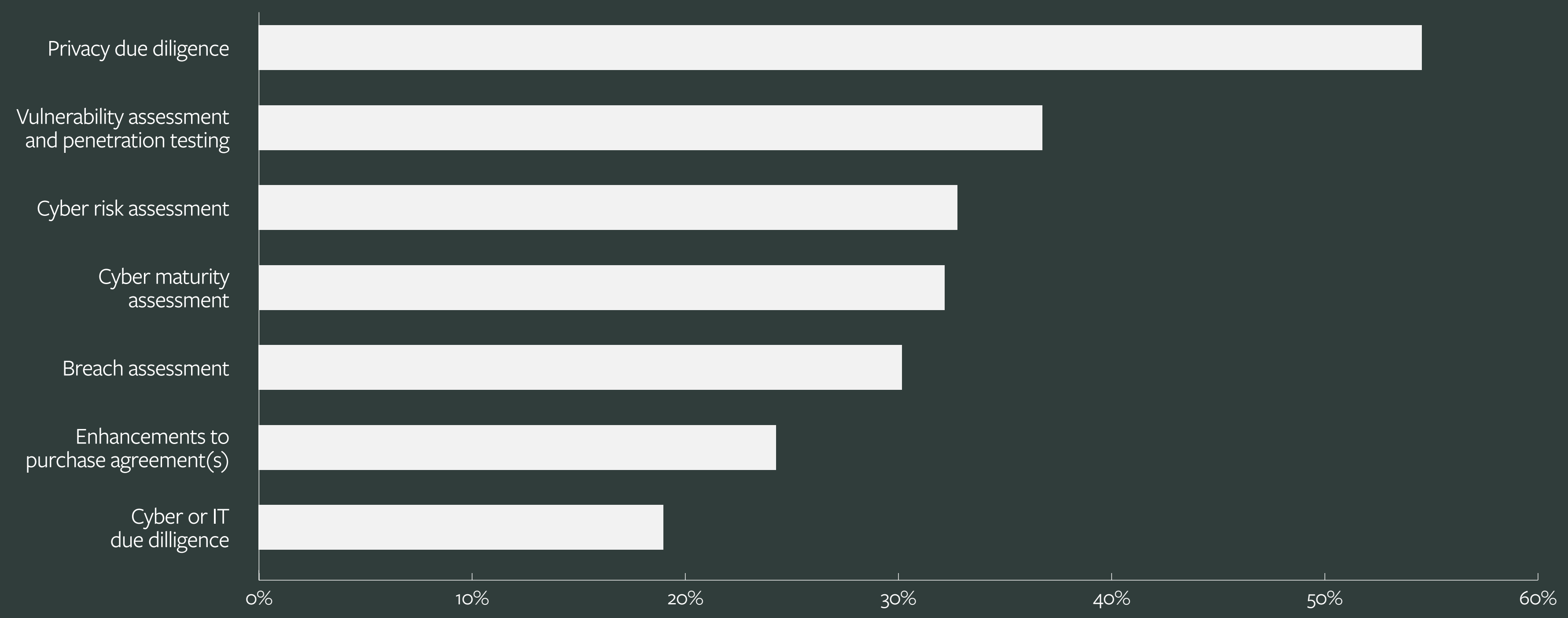


Figure 14
Which of the following precautionary measures are you taking around data protection and cybersecurity in transactions?



Alternative Payments

U.S. and global equity markets were hit hard by the emerging macro risks last year, forcing some indices to record their worst performance since the 2008 financial crisis.

In the short-term, such equity market underperformance raises strategic questions for companies, including how they may pay for an acquisition. While 53% of our survey respondents said they would not be concerned about using stock, all or in part, to pay for an acquisition, 41% said they would be concerned (see **Figure 15**). Longer term, alternative methods of payment to stock and other traditional financing formats are on the rise. Digital currencies – including cryptocurrencies and stablecoins – is one such alternative.

Trepidation is still widespread given recent crypto market events and the overall risks involved in an emerging asset class. But for dealmakers, they are asking whether digital currencies can play a larger role in financing M&A. At the time surveyed, many saw the use of these currencies as a viable option; 49% of executives said they believed it is entirely possible to use digital currencies to pay for acquisitions in full or in part and that their company plans to do so. In comparison, 38% believed it is entirely possible but that their company is unlikely to do so, while 7% responded they had already done so (see **Figure 16**).

The cryptocurrency industry has recently suffered significant reputational damage, with some high-profile corporate collapses eroding confidence. It is uncertain how far it will take hold in the M&A sphere in the future, but practitioners seem likely to keep a close eye on any developments in that direction.

49%

of executives said they believed it is entirely possible to use digital currencies to pay for acquisitions in full or in part and they plan to do so

Figure 15
Given recent equity market volatility, would you be concerned with using stock – all or in part – to pay for an acquisition?

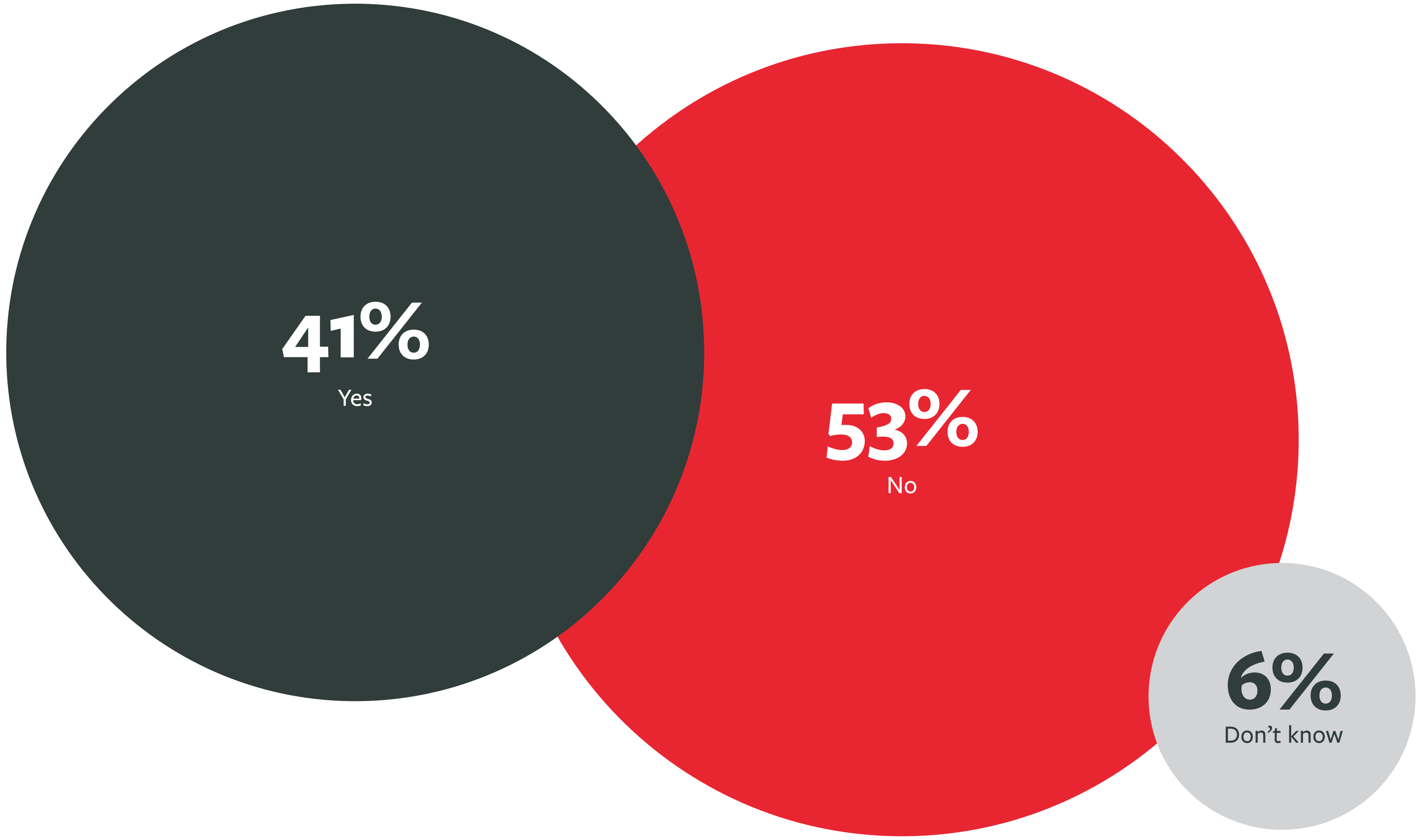
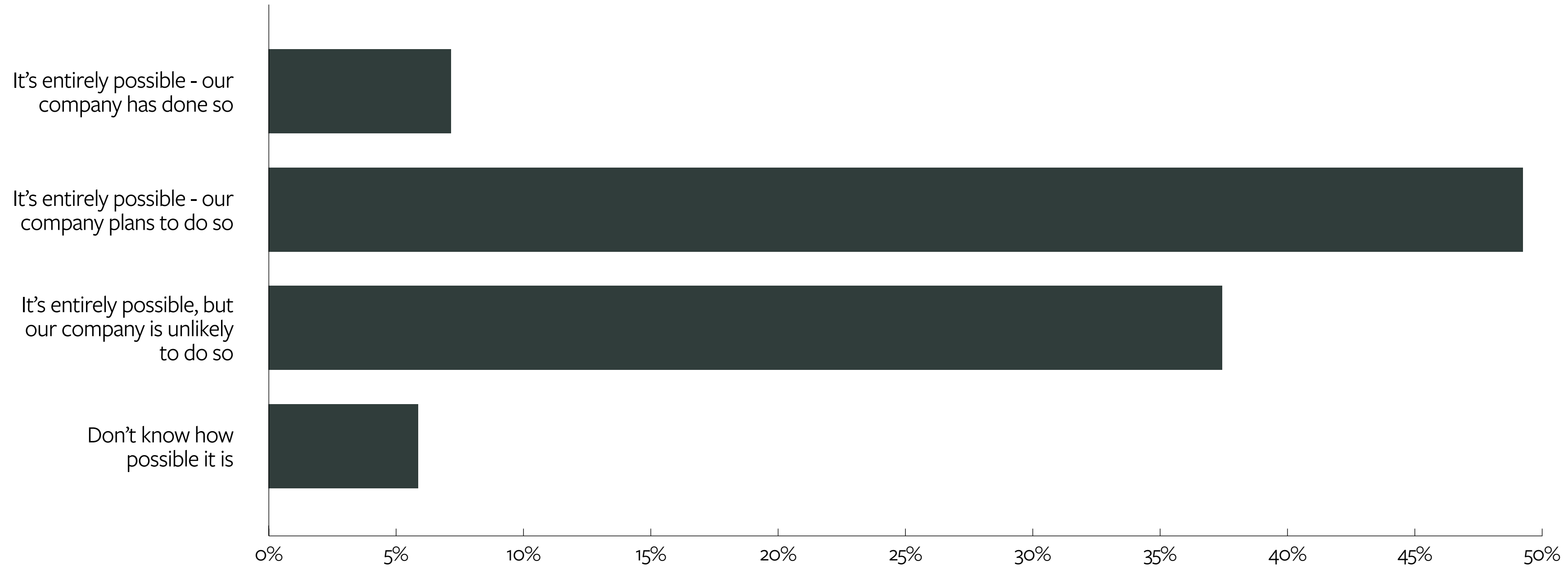


Figure 16
How do you assess the potential to use digital currencies to pay for acquisitions in full or in part?



Conclusion

While the U.S. M&A market was hit hard in 2022, optimism abounds. Dealmakers believe that activity will rebound in 2023 as U.S.-based companies across all industries seek to capitalize on growth and investment opportunities and plan to spend cash they may have been holding onto as they sat on the sidelines this past year.

This comes amid economic uncertainty and a more challenging financing environment, but most companies in our survey seem to see through this and are focused on forging ahead with their M&A plans for 2023.

As dealmakers focus on 2023, there are several areas that will likely influence their decision-making and the deals they approach and complete, as our survey shows. Investor activism, ESG matters, and technological advancements will all impact when and how M&A parties do business in 2023. The market for R&W insurance is still strong, but it remains to be seen if the market will shift back towards traditional escrows as the balance of power between buyers and sellers resets.

After a challenging year, U.S. dealmakers are preparing for a busier 2023. While some of the same economic challenges will persist, attractive opportunities abound, and dealmakers have those opportunities in their sights.

Methodology

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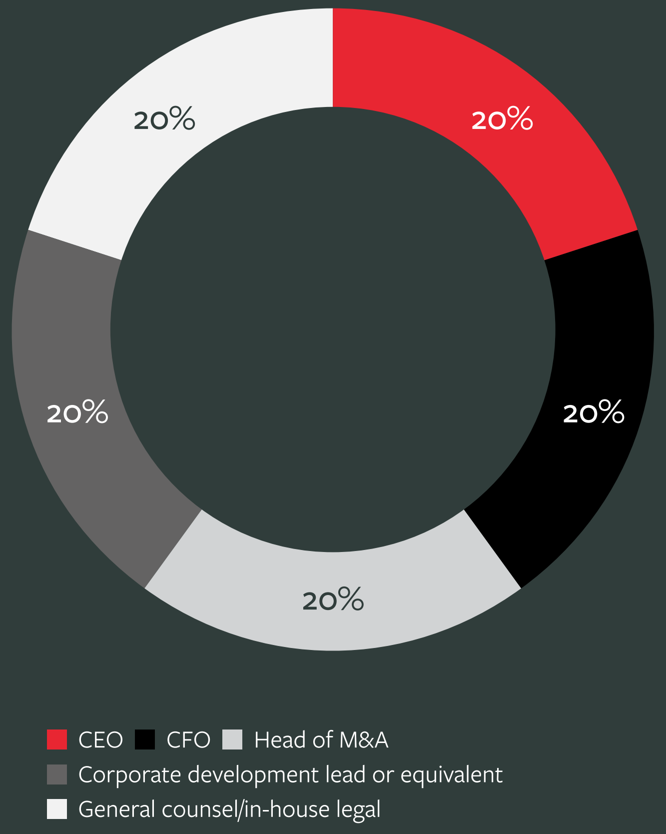
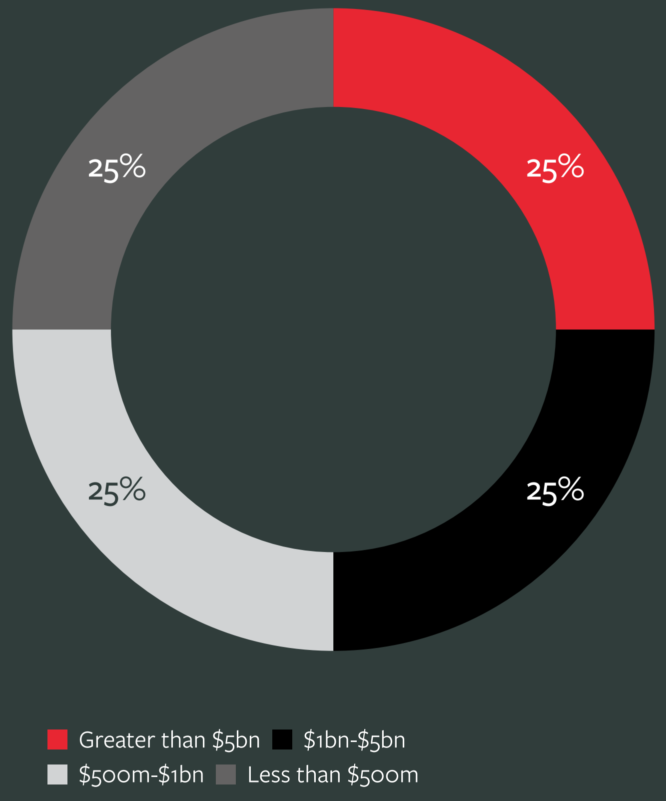
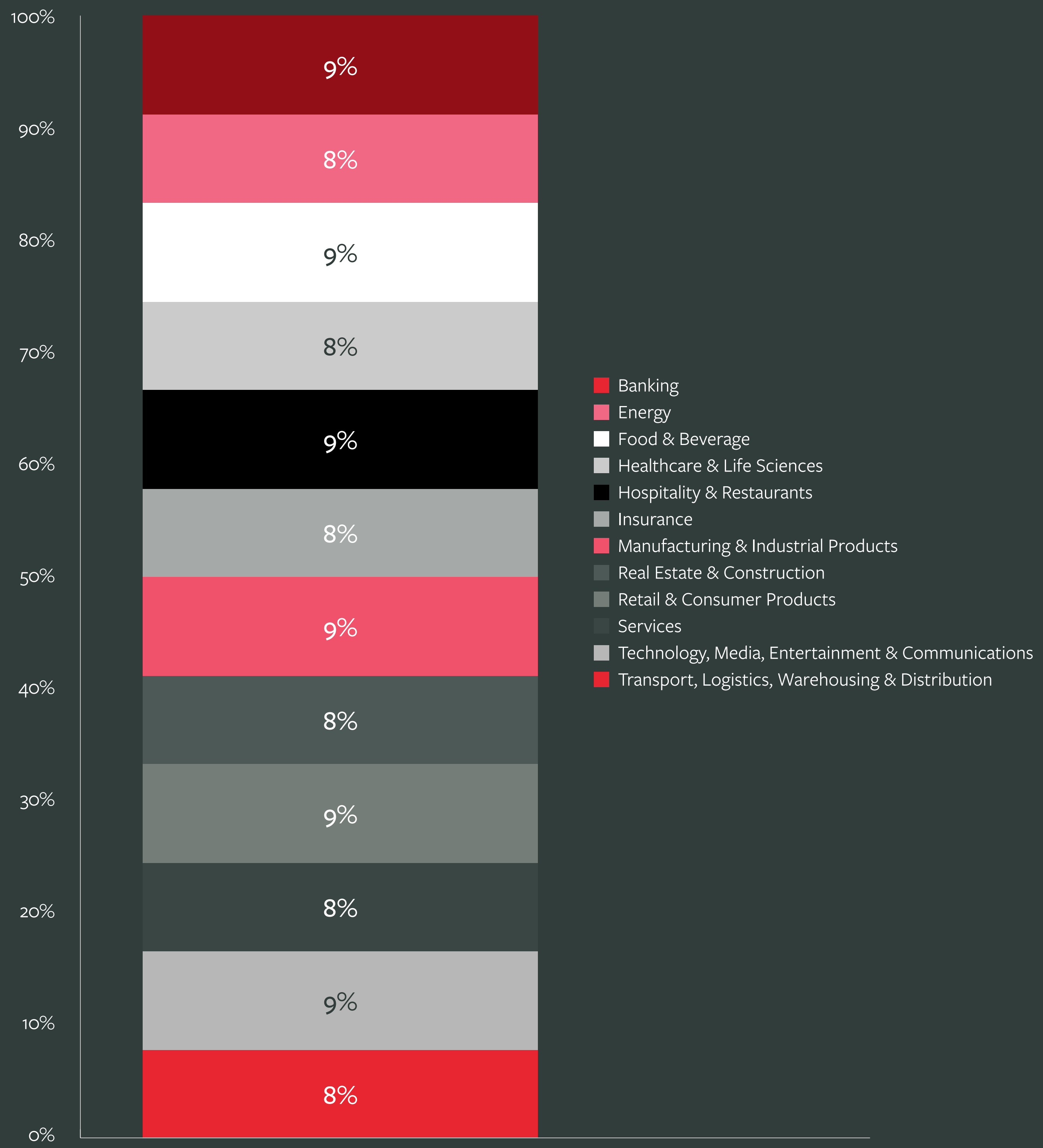
Respondents by title/role



Respondents by company size (annual revenue)



Respondents by industry (annual revenue)



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