

## PRIVATE EQUITY'S ROLE IN M&A CONTINUES TO GROW

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### SUMMARY

- In 2022, the global economic backdrop was not conducive to M&A activity, which declined especially fast in the second half of the year.
- The volume of deals held up better in the US than in Europe in H1—thanks to mega deals (over USD 40 bn) in the tech sector—before a significant slowdown in H2.
- Whereas US companies kept buying in Europe, the reverse was not the case as the strength of the USD held back European buyers.
- With plenty of dry powder, private equity firms continued to increase their share of M&A deals in 2022.
- The valuation of target companies declined in the US, where M&A activity was primarily driven by big deals in the tech sector. In Europe, where there is less predominance of growth stocks, valuations increased slightly.
- Given depressed stock prices, deals were largely paid in cash and therefore financed by debt, but rising interest rates were a brake to M&A.
- The average premium over market prices for tie-ups was a high 40% in 2022.
- We expect economic and geopolitical uncertainties to continue to challenge M&A activity in 2023, although private equity firms should remain active thanks to dry powder. M&A could attract companies eager to protect margins at a time of intensifying margin pressure.

### Sharp drop in M&A in H2

The number of global M&A deals soared to a 14-year high in 2021, fueled by policies to support pandemic-stricken economies that pushed the cost of funding to historical lows. Activity remained healthy in the first half of 2022 but fell sharply in the second half, leaving the number of global M&A transactions over 2022 as a whole 32% lower than the previous year (but still higher than in 2020). While this was the steepest one-year decline in the number of deals since 2009, the value of transactions completed in 2022 fell a slightly less daunting 25%, from USD1.68 bn in 2021 to USD1.26 bn in 2022.

### Resilient in the US but slowing significantly in Europe

Most of the decrease in global M&A last year was in Europe, whereas activity held up in the US. The total value of deals in the US reached USD734 bn in 2022, up from around USD720 bn in 2021. But even in the US, transactions dried up as the year progressed, with the total value of US M&A deals concluded falling from USD546 bn in the first half of 2022 to USD188 bn in the second half (*see chart 1*), equivalent to a decline of 65%. This was the biggest intra-year drop since 2009 and reflects repeated rate hikes that hindered acquirers' capacity to fund deals.

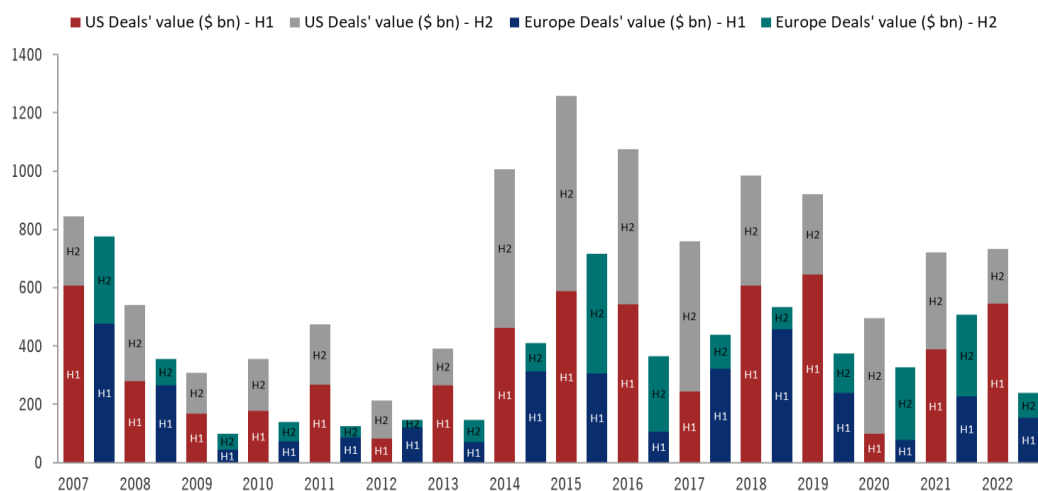
Unlike the US, M&A activity in Europe slowed down significantly in 2022 as a whole. The value of deals there fell to around USD240 bn, 53% lower than in 2021, with the decline especially pronounced in H2. Deal value in Europe declined by 42% between H1

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and H2 (from USD152 bn to USD88 bn) as the Ukraine war and the surge in energy prices took their toll. In addition, currency weakness against the dollar stymied European acquirers' capacity to finance overseas deals.

CHART 1: INTRA-YEAR VOLUME OF M&A DEALS IN THE US AND EUROPE, 2007-2022



Source: Pictet Wealth Management, FactSet, as at 31.12.2022

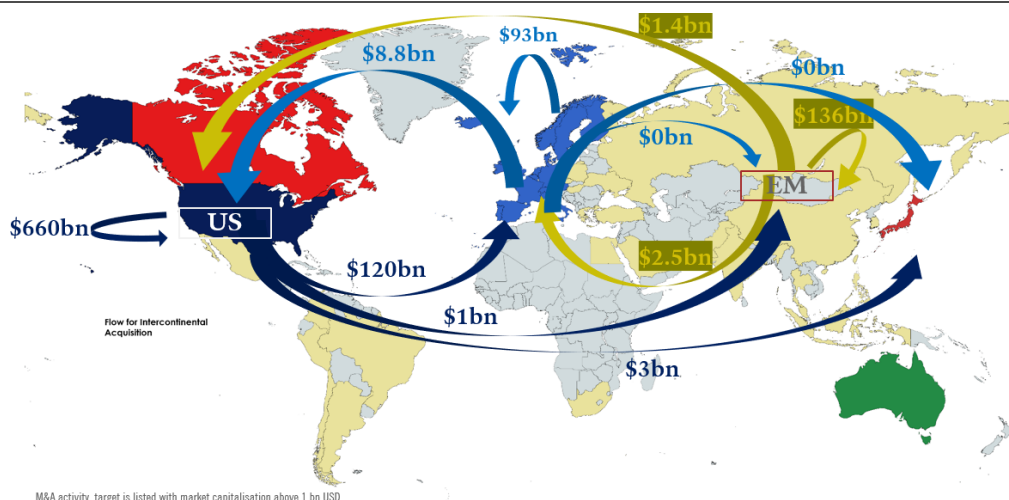
### Cross-border M&A activity slows

Impacted by geopolitical and economic uncertainties, as well as rising interest rates, cross-border M&A activity slowed down in 2022. But would-be deal makers in Europe suffered more than in the US given the weakening of European currencies against the US dollar. The result was that while US-originated deals for European companies fell by 40% in 2022 (to USD120 bn), the volume of Europe-originated deals for US firms plunged by 90% (to USD9 bn). M&A flows from the US to Europe exceeded flows inside Europe itself (see figure 1).

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FIGURE 1: CROSS-BORDER FLOWS IN 2022 (USD BN)



Source: Pictet Wealth Management, FactSet, as at 31.12. 2022

### Mega deals lift the value of US M&A deals

In 2022, mega deals (over USD40 bn) increased significantly both in number and value in the US and in Europe alike, accounting for around 20% of the value of all M&A deals last year. However, this is still lower than in the years from 2014 to 2019, when mega deals represented 30-40% of the value of global M&A.

Mega deals were concentrated in the first half of last year, with none recorded in the second half by FactSet. While Elon Musk's acquisition of Twitter, worth about USD40 bn, was the one that caught the most attention, the largest deals in the first half of 2022 were Broadcom's acquisition of VMware and Microsoft's acquisition of Activision Blizzard, each worth about USD68 bn (these latter two deals are still pending completion).

Thanks to mega deals, tech-related sectors accounted for 48% of the dollar value of M&A in the US last year, to be compared to 31% of the number of deals. In Europe, transportation was the main object of M&A deals, representing around 28% of total deal value, followed by the financial sector (16%).

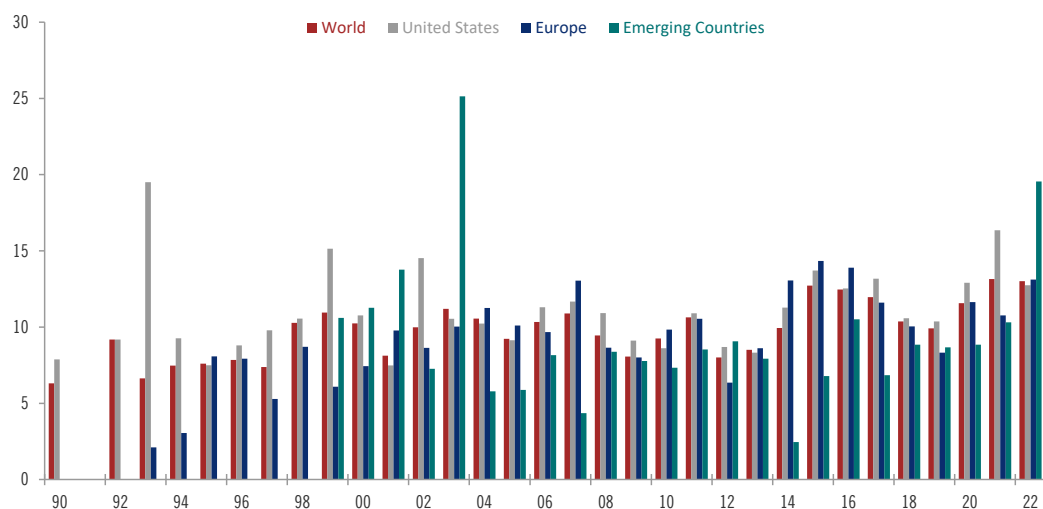
### Valuations fell in the US but rose in Europe

The weighted average valuation of deal targets, as measured by their ratio of enterprise value to earnings before interest, taxes, depreciation, and amortisation (EV/EBITDA) decreased from 16x in 2021 to 12.7x in 2022 in the US, but remained slightly above the level seen in 2020. The prevalence of publicly traded tech-related companies explains why valuation multiples fell sharply in the US, with the 12-month forward EV/EBITDA on the S&P 500 declining from 14.3x to 11.3x over the course of 2022. By contrast, valuation multiples increased in Europe, where growth stocks are less prevalent (see chart 2).

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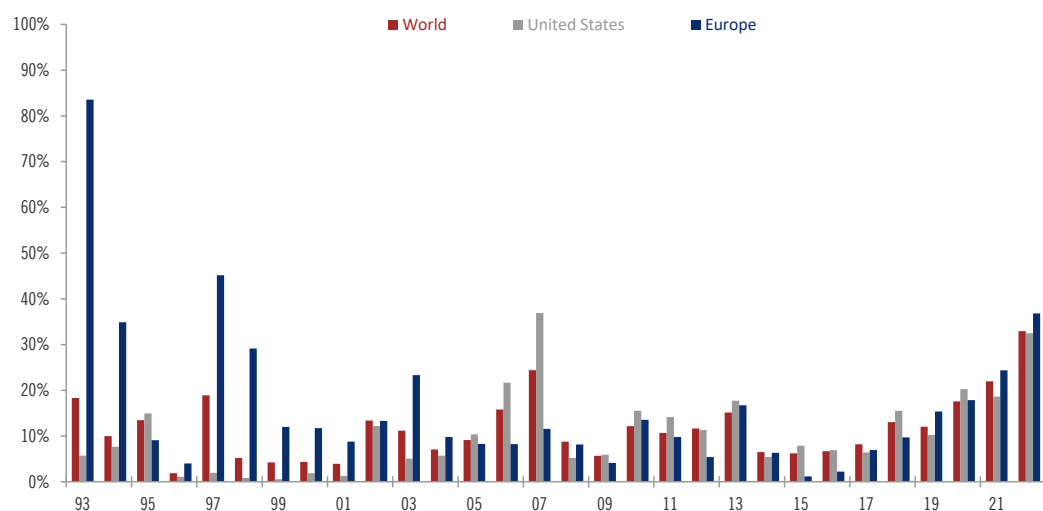
CHART 2: EV/EBITDA OF M&amp;A TARGETS, 1990-2022



### Private-equity firms remained active in 2022

Private-equity buying helped M&A activity in 2022, increasing further last year as it has every year since 2018 (see chart 3). In recent years, private-equity firms have accumulated a lot of dry powder that can also be deployed on listed markets through M&A transactions. At the end of December 2022, Pitchbook database estimates that the dry powder of global private equity stands at USD 1250 bn. Trends in the US and Europe are broadly similar, with 37% of deals in Europe involving a private acquirer, the highest level in 24 years.

CHART 3: PRIVATE EQUITY AS A % OF DEAL VALUE



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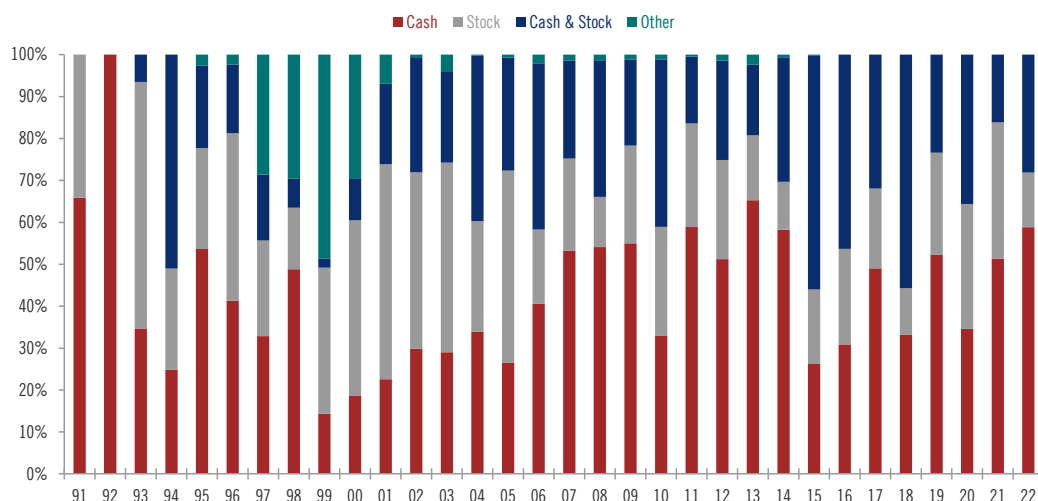
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Historically, deal values have been smaller when private acquirers have been involved, but there was a slight size premium for private-equity deals in 2022.

### Cash deals dominate

The decline in equity markets in 2022 meant that the proportion of deal transactions paid for only in stocks declined relative to those exclusively in cash. Deals paid in cash accounted for 76% of the total in 2022 by value of global deals compared with 67% in 2021, rising to close to the previous peak reached in 2013 (see chart 4). The increase was more marked in the US, where 83% of transactions were paid for in cash in 2022, compared to 60% in 2021. The main source of financing for cash deals is either debt or internal funding. This means the fast rise in interest rates from mid-2022 on weighed on the ability of the buyers to fund deals.

CHART 4: BREAKDOWN OF DEAL FINANCING BY VALUE, 1991-2022



Source: Pictet Wealth Management, FactSet, as at 31.12.2022

### Elevated deal premiums

Traditionally, many announced M&A deals are not actually completed. The number of cancelled deals has been higher in Europe than in the US over the past 10 years, but declined in both places in 2022—to 17% in Europe (down from 25% the previous year) and 7% in the US (the lowest level in over 20 years).

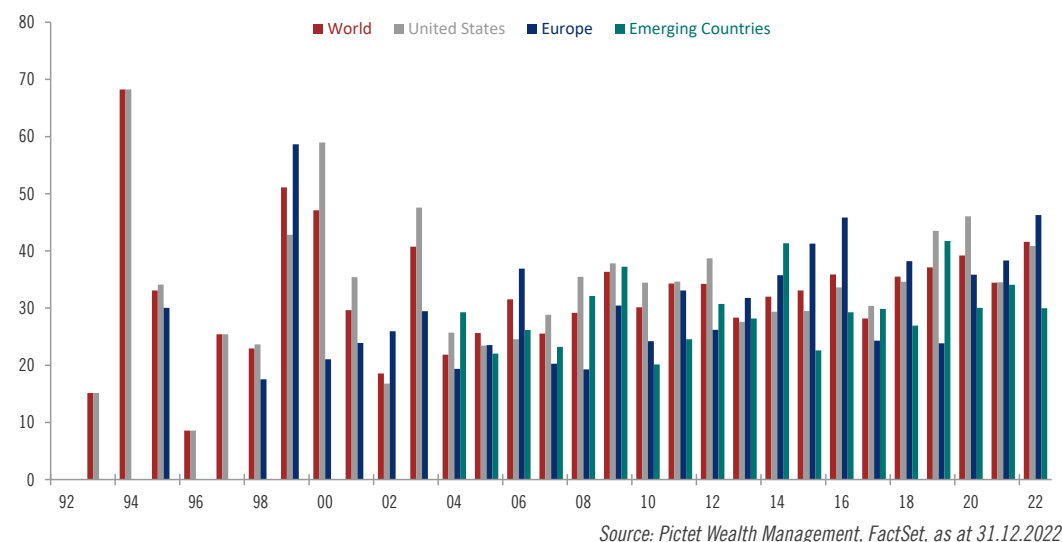
But there are things that do not change—for example, the trend to pay increasing premiums for target companies. The average premium paid relative to the price per share of a target company one month before a deal announcement rose continually from 2018 to 2022, reaching around 40% last year (see chart 5). The increase was stronger in Europe, where average deal premiums returned to the previous peak reached in 2016. In a

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nutshell, while there were relatively few deals announced in Europe in 2022, acquirers paid a high price for those that were.

CHART 5: ONE-MONTH PREMIUM PAID FOR M&A TARGET



### 2023 outlook

The economic environment in 2022 was particularly unfavourable for M&A. The war in Ukraine, soaring energy prices and rising inflation shook investor confidence, while tightening monetary policy weighed on the ability of companies to finance transactions. Resilient in the first half of the year, M&A activity slowed down significantly in the second half.

Economic uncertainties could continue to be a hurdle for M&A globally in 2023, with the increasing cost of funding and an economic slowdown pushing buyers to focus more on smaller deals.

However, the economic downturn may provide opportunities for strategic buyers to look at companies with strong growth prospects that are now trading at cheaper valuations than before. Companies may turn to M&A as a way to protect elevated margins that are coming under increasing pressure. In addition, the stock of dry powder that private-equity firms have available should keep supporting M&A, especially if economic uncertainties progressively fade. Finally, European buyers looking to the US for acquisitions should be helped by the euro's rebound against the USD.

### Methodological comments

*Raw M&A data from FactSet focuses solely on listed companies and excludes private ones. Our analysis also excludes deals worth less than USD1 bn as well as Initial Public Offerings (IPOs) and Special Purpose Acquisition companies (SPACS). All data relates to announced deals only for the year up to 31 December 2022.*

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