Q2 2018 BUSINESS PRODUCTS AND SERVICES SPOTLIGHT
M&A trends and private equity deal activity
“The market is in wait-and-see mode on tariffs, and we’re talking to our clients to make sure they can pivot as soon as they need to.”

Michael Fanelli,
Partner, Transaction Advisory Services
Both private equity (PE) and mergers & acquisitions (M&A) activities continue apace in the business-to-business (B2B) space. Almost $60 billion of PE capital was invested in Q2 2018, in line with recent strong quarters, while another $212 billion was spent on B2B-related M&A deals last quarter, which was also in line with recent figures. It is unclear how either number will be affected by the tariffs imposed by the United States on China, Canada, Japan and several members of the EU. Some RSM clients are concerned about the impact on importing and exporting goods. RSM estimates that the United States tariff structure amounts to a cost of approximately $915,000 per job to protect the steel and aluminum industries; and the 25 percent tariffs on steel and 15 percent tariffs on aluminum on key trading partners are estimated to shave 0.2 percent from potential growth and put more than 2 million jobs at risk. If a full-blown trade war does break out, the impact on the U.S. economy will be large and difficult to quantify, given uncertainty over how financial markets would react to the use of financial weapons and competitive currency devaluations. Middle-market businesses should discuss with their advisors how to prepare in the event of a protracted trade conflict.
The United States imports $2.4 trillion worth of goods and services each year that it otherwise does not produce. Potential import targets based on the administration’s threats include autos (about $176 billion or 8 percent of total trade), aluminum (around $13 billion) and steel (roughly $30 billion). Together, those industries account for about 0.21 percent of total gross domestic product. The most-exposed middle-market (MM) businesses to recent tariffs imposed by the Trump administration are those downstream in the manufacturing, agricultural, construction and industrial products ecosystems. If the trade spat intensifies and begins to include consumer products, the broader retail, footwear and apparel industrial ecosystems will be hardest hit in the near- to medium-term. A tit-for-tat retaliatory trade war that spills over into the broader consumer industry would have the greatest impact on the two lowest quintiles of income earners.
The uncertainty imposed on the United States industry due to the intensification of trade spats will likely cause MM businesses that have export exposure to China or that are consumers of steel and aluminum to absorb higher prices in advance of full implementation. There are already signs that tariffs are impacting investment activity. The price of Canadian soft lumber has increased by 20 percent already this year, which has caused United States home prices to appreciate by more than 1 percent, an increase directly linked to the tariff. Similarly, aluminum prices are up more than 25 percent this year, while steel prices are up nearly 30 percent. As a result, MM businesses will likely need to adjust to narrower profit margins and net revenues going forward as they explore passing price increases on to customers.
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PE DEAL ACTIVITY RAMPED UP.

B2B volume and total value on pace for strong 2018 with $135B across 1,284 deals.

PE deals accounted for 36 percent of Q2 M&A, highest percentage in several years.

CLAMP DOWN ON EXIT RAMPS.


2018 is on pace for a 28 percent year-on-year decline in PE exits.

28%

UNPREDICTABLE TARIFF AND TRADE POLICIES ARE ALREADY CAUSING DECLINES IN DOMESTIC STEEL DEMAND.

The Trump administration imposed 25 percent tariffs on steel and 15 percent on aluminum for six key trading partners on June 1, with heavier tariffs for China beginning June 15.

New U.S. tariff structure amounts to an estimated $915,000 per job to protect the steel and aluminum industries.
WAIT-AND-SEE APPROACH FOR STRATEGICS

M&A activity took a dive in Q1 by deal counts, though recent quarters have been largely consistent across the sector. Total value has also been consistent, notching at least $250 billion in 10 of the last 14 quarters. Slowing corporate M&A activity may be due to hesitation around new trade policies and how they may impact strategic directions of individual firms, though any widespread impact will be more apparent in the quarters ahead.
PE DEAL ACTIVITY RAMPED UP

B2B volume and total value are on pace for a strong 2018, with $135 billion invested across 1,284 deals. While volume has crept down over the past several quarters, value has remained sturdy, resulting in increasingly high median deal sizes over the past two years. PE interest in manufacturing is likely to remain resilient despite fears of a trade war, but investors are also likely to be more cautious as various tariffs are introduced going forward.
BUT EXIT RAMPS SLOW DOWN
PE exits in the B2B space posted their two slowest quarters in recent memory to start 2018. Much of today’s slowdown reflects a pause on strategic acquisitions, helping prop up PE’s share of overall M&A activity. Moreover, it would not be surprising to see a sustained downturn in B2B exits, considering the historic seller’s market that has lasted for more than four years.

Source: PitchBook
THE VALUE OF RSM’S MIDDLE-MARKET LEADERSHIP

Focusing on the middle market, RSM US provides integrated transaction advisory, tax, assurance and consulting services. Our work with 2,700 middle-market businesses and professional services companies gives us a deep understanding of the key trends impacting the industry. In addition, we have performed due diligence on more than 2,200 deals in the past five years, nearly 200 of which were business and professional services transactions. This in-depth knowledge provides our private equity and strategic buyer clients with industry-specific due diligence considerations.