

2017 Automotive Mergers and Acquisitions Outlook

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As we stand here in early 2017, we are further away from the all-time high in valuations and deal activity that we witnessed in 2015; but despite signs that the extended expansion cycle for the industry may be plateauing, automotive appears poised to remain a leading sector for M&A activity through 2017. Prognostics for macroeconomic factors are mixed. We have now seen two interest rate hikes by the Federal Reserve, which all else being equal reduces the amount of debt financing for potential buyers in a particular deal. However, so long as the generally positive outlook for global economic growth is realized (driven in part by a strengthening U.S. economy and renewed optimism), we hope to see that any downturn in deal activity for 2017 to be modest at worst. Opportunities in hot sectors such as connected and autonomous driving electric vehicle and lightweight material technologies, and generally throughout the component supplier market, should continue to entice buyers to remain active in the market so as not to be left standing on the fences. However, the days of a continuing upward trajectory of deal multiples across the entire industry appear to be over, at least for the near term.

Valuation Multiples Are Coming Back to Earth

Deal multiples in 2016 fell from the highs of 2015. According to PricewaterhouseCoopers (PwC), for 2016 the average EBITDA (earnings before interest, taxes, depreciation and amortization) multiples for deals in the automotive industry (including public company valuations) was 8.8x, down from 13.6x for 2015. A good part of this trend is accounted for in several megadeals in 2015, and while total automotive deal dollar volume decreased 34% in 2016, the number of deals only decreased 1.4% according to PWC. This confirms what middle market M&A practitioners saw in 2016: a still healthy market with decent multiples. A key open question for 2017 is whether the deal multiples will stabilize or continue their downward trajectories.

Interest Rates Are Rising in 2017

The surge in deal activity in the past few years has been fueled in no small part to sustained historically low interest rates that have provided buyers access to cheap money. With solid economic reports and unemployment rates continuing to drop, we entered 2016 with Federal Reserve officials predicting four rate increases during the year. As it played out, the sole interest rate hike of 2016

occurred in December 2016, followed by another hike in March 2017. If the Federal Reserve continues to raising interest rates in 2017, we can expect overall deal activity to slow especially for buyers such as private equity funds who rely on debt financing to facilitate dealmaking.

The Trump Card: What Impact Will Trade Policy Changes Have on the M&A Market?

The largest wildcard that may impact M&A activity in 2017 is the uncertainty relating to trade policy changes from the new Trump administration. Certainly, potential changes to NAFTA and the potential imposition of a border adjustment tax will be a centerpiece of that uncertainty, given the heavy flow of component parts and assembled vehicles among the U.S., Mexico and Canada; but other factors such as possible changes in the U.S.'s relationships with China and Europe could all have major impacts on deal activity. Uncertainty is generally bad for dealmaking as it makes business due diligence more troublesome, and sometimes that uncertainty can drag down or delay decision making. The impacts of any trade policy changes will continue to be watched closely as we move further into 2017.

Connected and Autonomous Vehicle Technologies Continue To Drive Activity

Perhaps the highest profile development in the automotive M&A market in the past few years has been increase of deal activity driven by emerging technologies in the smart cars, electric vehicles, connected and autonomous driving and ride sharing. Companies from the major automakers down through the supply chain, to technology and start-up companies traditionally outside of the automotive space, have raced to invest in, acquire and develop these technologies. General Motors made headlines with its recent \$1 billion acquisition of autonomous vehicle developer Cruise Automation. More recently in March 2017, Intel announced its intention to buy Israeli-based Mobileye for a mere \$15.3 billion! Automotive companies are using M&A as the fastest strategy for acquiring technology, and we can expect this trend to continue in 2017.

Light Weighting Will Continue?

Deal activity in the vehicle light weighting area has been strong. According to a 2016 special report on vehicle light weighting published by McKinsey & Company, the prices that OEMs are willing to pay for lighter weight are likely to continue to rise. The McKinsey & Company report cited several contributors to this trend, most notably the government mandated fuel economy standard requirements, which in the U.S. currently targets a 54.5 mpg fleet average by 2025. Now that the Trump Administration has announced that the Environmental Protection Agency will continue to review the implementation of these rules (a change from the late days of the Obama Administration), the imperative to light weighting is now more cloudy. Given the benefits of light weighting and the long platform development lead times however, we do not expect regulatory uncertainty to bring deal activity to a halt.

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