ACG® New York

Association for Corporate Growth

Where Private Capital Meets The World

Last week, we attended the ACG New York 2018 State of Union Luncheon event. Here are five of our top takeaways from the panel, which focused on the changing dynamics of the business cycle and M&A landscape of the US Economy.

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5 THINGS YOU MISSED LAST WEEK –

1 **Changing Business Cycle:** The economy is changing. The last business cycle ended over 10 years ago and the recovery started in March 2009, but this recovery has been very anemic primarily because the last recession was a credit-induced recession. The current cycle has also faced headwinds from the recent financial crisis, as evidenced by increased regulatory burdens, weak business sentiments, increased tax burdens, pushback on M&A activities, all of which burden the growth of the economy. However, policy initiatives have led to a change in business sentiments. With the acceleration of capital expenditures, wages etc., not only has the economy began to accelerate, but a policy initiative has added fuel to fire. Hence, 2018 is going to witness more policy-induced growth. According to Tim Hopper, Founder of Macro Fund Advisors, "*We are entering the more mature stage of the business cycle.*"

2 **Economic Variables and Interest Rates:** According to Tim Hopper, the traditional measures of inflation haven't risen much in the last few years due to the effects of decreased interest rates on the asset prices. But the traditional measures will begin to re-assert themselves later in 2018 and 2019. The inverse relationship between interest rates and commercial property values, which was not existent for the past decade, will restart mostly in 2019. Additionally, portfolios might have to be realigned to account for the effects of the traditional rise in interest rate.

3 **Buy a Business:** The lowering tax rates will boost earnings in 2018, thereby providing a tailwind to the Enterprise Value. The impact of taking an effective tax rate from an average rate of ~23% down to ~18% translates to a 10% – 20% earnings boost in 2018 and Enterprise Value boost of between 10% - 15%. Tim Hopper – "*People making transactions in the private sector should buy a business (mostly, automotive and real estate) since if you wait longer, you will have to pay more because of the increase in Enterprise value.*"

4 **M&A and Tax Reforms:** With the drop in the corporate tax rate, the Strategics will become more competitive in the M&A market. 2018 will continue to bring a fairly robust M&A market, as there is a lot of dry powder in the market. However, elevated valuations (median EBITDA multiple of ~10.0x), along with competitive advantage for Strategics on account of lower rates, pose significant challenges. The PE firms need to think about the complexity premium and act in ways which distinguish them from others, such as by taking private, etc.

5 **New Technology Innovation:** The automotive industry is in the 3rd big innovation cycle of their century-old industry, as per Jiten Behl, Chief Strategy Officer at Rivian Automotive, because of intersection of this industry with technology. Statistics state that over $110 billion capital has been infused in the last 5 years in the automotive industry due to innovation. Players from different industries are converging into the automotive space. But according to Pamela Hendrickson, COO and VP of The Riverside Company, the more tech enabled a business, higher is the multiple and hence, specialty manufacturing and distribution industries seem to be more favorable given the lower multiples. Technology advancements have also led to PEs focusing on their portfolio companies adopting these new platforms to grow their underlying business.