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2014 M&A Outlook Survey Report

M&A Expected to Rebound in 2014

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Foreword

This past year provided several reasons for executives to feel optimistic about the economy. The Dow Jones surpassed 15,000 points, companies have been issuing IPOs at a record pace and Europe appears to have stabilized. However, despite a few large deals, such as Verizon Communications' announced purchase of Vodafone's 45 percent share of Verizon Wireless for $130 billion, the M&A market has been relatively tame. For the first nine months of 2013, global deal volume decreased almost 13 percent while global deal value increased two percent, according to Thomson Reuters.

Several factors indicate that deal volume should become more active. Companies continue to hold massive amounts of cash and interest rates remain at historic lows. However, uncertainty concerning the Federal Reserve's monetary policy and the implementation of healthcare reform, coupled with stubbornly high unemployment, is keeping Corporate America cautious. In order to gain a better understanding of the current M&A market, KPMG and *Mergers & Acquisitions* magazine have conducted a survey of over 1,000 M&A professionals, including those at U.S. corporations, private equity (PE) firms, and investment banks.

Deal Activity Expected to **Be Solid**

In general, survey participants felt relatively positive about the deal environment. Approximately 63 percent of respondents said that they planned to be acquirers in 2014.

Q: Which factor do you think will most facilitate deal activity in 2014?

Large cash reserves/commitments	25%
Opportunities in emerging markets	17%
Availability of credit on favorable terms	16%
Improved consumer confidence	16%
Improving equity markets	9%
Recovery of financial services sector	9%
Improved employment numbers	5%
Other (please specify)	3%

Twenty-one percent said their companies planned to initiate one acquisition in 2014 and 16 percent said they planned to initiate two deals. Only 16 percent said that their companies were not planning any acquisitions in 2014.

When asked why they expected their companies and clients to engage in more deals in 2014, numerous respondents cited an improving economy, less economic uncertainty, and pent-up demand. One corporate development officer at a diversified industrial company said he was planning for an increase in M&A because of the existence of "better economic conditions and less uncertainty." As one optimistic investment banker said, deals should increase "because next year can't possibly be as bad as this year."

Several factors should facilitate deal activity in the coming year. The largest percentage of respondents (25 percent) cited large cash reserves. Other important factors were opportunities in emerging markets (17 percent), improved consumer confidence (16 percent), availability of credit on favorable terms (16 percent), and improving equity markets (9 percent).

Dan Tiemann, Americas Transactions & Restructuring lead for KPMG, agrees that M&A should begin to pick up in the near future. "Executives are reassured by the improving global economy and decreasing uncertainty. Large cash reserves and attractive investment opportunities should result in more deal-making for U.S. companies. "PE buyers should also become more active in the next 12–18 months, according to Marc Moyers, KPMG National Sector Leader for PE. He said, "Many PE funds have large amounts of uninvested capital and are seeking attractive opportunities, especially in emerging markets and in industries that exhibit the potential for above average growth."

Growth Motivates Deals

Which factors are motivating today's deal-makers? Respondents said that their primary reasons for making an acquisition were opportunistic (18 percent), to expand their customer base (17 percent), and to expand their geographic reach (17 percent).

Q: Beyond increasing revenues or cutting costs, what is the primary reason you will initiate a deal in 2014?

Opportunistic (i.e., target becomes available)	18%
Expand customer base	17%
Expand geographic reach	17%
Enter into new lines of business	14%
Introduce new products	9%
Financial buyer looking for profitable operations and/or gain on exit	8%
Deploy capital	8%
Enhance intellectual property	4%
Invest in another function in the supply chain	3%
Defend against competition	2%

Another significant percentage sought to introduce new products (9 percent). When asked if their companies' deal motivation has changed in the last two years, several respondents said that they were focusing less on cost cutting and more on growth. As one oil and gas executive said, "We are changing from divesting non-core operations to expanding new operating areas."

Last year saw several blockbuster deals; however, the middle-market is expected to be the most active sector. Respondents confirmed that deal size is expected to remain on the smaller side.

Q: What do you anticipate the average enterprise value per acquisition for your company will be in 2014?

Less than $250 million	77%
$250 million to $499 million	12%
$500 million to $999 million	5%
$1 billion to $5 billion	3%
Don't know	2%
Greater than $5 billion	1%

Over three-quarters (77 percent) of respondents said that they expected their deals to be valued at $250 million or less. Twelve percent of respondents said their companies would be involved in deals valued between $250 million and $499 million and just three percent said their companies would be doing deals valued between $1 billion and $5 billion. KPMG's Phil Isom, Principal and U.S. Lead of Corporate Finance and Restructuring, said he continues to see these smaller deals dominating the marketplace. "Despite many structural improvements, today's economy is still uncertain and these smaller deals are easier to finance and integrate," he said.

Creating shareholder value is a notoriously challenging process. According to the largest percentage of respondents (38 percent), the most important factor for deal success is a well-executed integration plan.

Q: What factor is most important for deal success?

Well-executed integration plan	38%
Correct valuation/deal price	29%
Effective due diligence	20%
Positive economic conditions	10%
Other	3%

Respondents also said that having the correct valuation and deal price was important (29 percent), as was effective due diligence (20 percent). Less important (10 percent) were general economic conditions.

Industry Trends and Challenges

There were no surprises in terms of industries in which the M&A professionals expected to see the most activity.

Q: Which two industries do you think will be most active overall in M&A in 2014?[1]

The largest percentage of respondents (44 percent) said that the most active industries would be technology, telecom, and media; a close second was healthcare, pharmaceuticals, and life sciences (41 percent). Respondents also expected active acquisitions in financial services (28 percent) and energy (27 percent). Tiemann said that "the industries where there are the most structural changes and those where regulations are prevalent create the most opportunities for consolidation. Increased and changing regulations concerning healthcare and financial services, enhanced oil and gas production, and the constantly evolving world of technology will generate increased investment opportunities."

44% Technology/media/telecom

41% Healthcare/pharmaceuticals/life sciences

28% Financial services

27% Energy/oil & gas

21% Consumer markets

18% Diversified industrials

[1] Multiple responses permitted.

Each industry is dealing with a different M&A landscape and a different set of challenges. In general, dealmakers were challenged by valuation disparities and the lack of suitable targets. Those whose industries were subject to government oversight, also noted the difficulty of dealing with an uncertain regulatory environment. The industry responses are made up of more than 100 M&A executives per industry.

Technology/Media/Telecom

According to the technology executives, the most important trends that will drive M&A next year are converging technologies (52 percent), cloud computing (43 percent), data analytics (43 percent), mobility (43 percent) and social networking (20 percent).[2] The primary reasons those in this sector were seeking out deals were to acquire tuck-in acquisitions, to enhance new products (19 percent), to enter into new revenues growth areas (18 percent), to expand technology platforms (14 percent), and to expand their customer base (14 percent). Deal making was most challenged by the valuation disparity between buyers and sellers (51 percent), the limited inventory of suitable targets (24 percent), the difficulty in identifying suitable targets (23 percent), and problems with buyer/target alignment on post-deal execution strategy (19 percent).[2]

Healthcare/Pharmaceuticals/Life Sciences

Not surprisingly, the number one trend behind M&A in this sector was expected to be the industry response to the Affordable Care Act, cited by 73 percent of healthcare executives. Other important trends include consolidation of core businesses/responding to competition (61 percent), product service growth (22 percent), and geographic growth (17 percent).[2] The most common challenges for healthcare M&A are expected to be uncertainty in the regulatory environment (62 percent), valuation disparities between buyers and sellers (38 percent), the inability to forecast future performance (37 percent), and the difficulty in identifying suitable targets (27 percent).[2] When asked how they anticipated dealing with the new healthcare exchanges, 38 percent of healthcare executives said they were uncertain; 30 percent intended to maintain company-based health insurance; 24 percent did not plan on making any changes; and eight percent intended to shift employees to exchanges as soon as practicable.

Financial Services

The most important financial services trend driving M&A is expected to be consolidation of core businesses/ competition (48 percent). Other key trends are increasing regulations that favor scale (42 percent), geographic growth (27 percent), technological advances (25 percent), and product and service growth (23 percent). The most common challenges for those interested in pursuing financial services M&A include uncertainty in the regulatory environment (57 percent), valuation disparity between buyers and sellers (34 percent), the inability to forecast future performance (34 percent), and the identification of suitable targets (32 percent). Executives predict that the most attractive sectors in financial services will be financial technology (20 percent), banking (18 percent), specialty finance (16 percent), and insurance (16 percent).[2]

Energy/Oil & Gas

According to oil & gas respondents, the most important trends driving M&A in this sector will be new technologies, including fracking (52 percent), geographic growth (35 percent), product/service growth (18 percent), and customer growth (13 percent). The issues that will most challenge deal makers in this industry are expected to be uncertainty in the regulatory environment (38 percent), valuation disparities between buyers and sellers (37 percent), volatile energy prices (36 percent), and the inability to forecast future performance (28 percent).

Consumer Markets

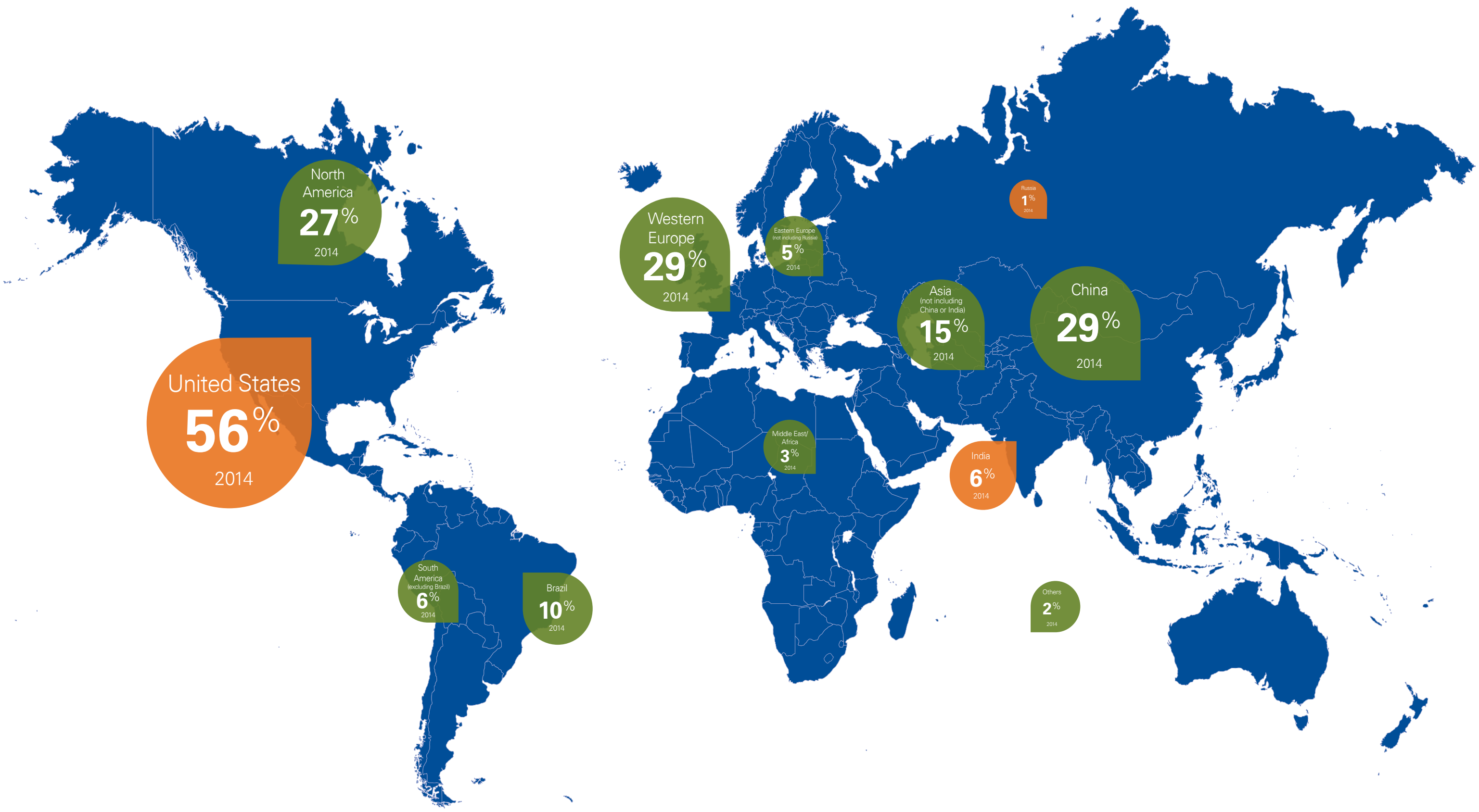
Consumer markets' executives say that the key trends driving acquisitions in this sector will be consolidation of core businesses/competition (62 percent), product/service growth (40 percent), geographic growth (31 percent), and customer growth (30 percent).[2] In terms of divestitures, consumer markets respondents say that their companies will be most motivated by the opportunity to sell non-core businesses (62 percent), the opportunity to monetize a successful business (44 percent), and the opportunity to sell an unprofitable business (35 percent).[2] The biggest challenges to deal making in this sector are the valuation disparities between buyers and sellers (53 percent), the inability to forecast future performance (40 percent), difficulties in identifying suitable targets (32 percent), and buyer/target alignment on post-deal strategy (20 percent).

Diversified Industrials

The key trends that will drive M&A in diversified industrials include market access (44 percent), cost cutting (43 percent), consolidation of the supplier base (38 percent), and technology advancement (28 percent).[2] The key trends that will drive divestitures are the opportunity to sell a non-core business (69 percent), the opportunity to sell an unprofitable business (38 percent), and the opportunity to monetize a successful business (35 percent).[2] Executives in this sector said that the most common challenges to deal making would be valuation disparity between buyers and sellers (59 percent), the inability to forecast future performance (42 percent), the identification of suitable targets (34 percent), and buyer/target alignment on post-deal strategy (19 percent).

[2] Multiple responses permitted.

U.S. Expected to **Lead Deal Activity**



Q: Which two regions or countries do you think will have the most active M&A markets in 2014?

The vast majority of respondents (83 percent) expect the United States and North America to be the most popular deal destination.

Other regions where M&A is expected to be robust are Western Europe (29 percent), China (29 percent), and Asia, not including China and India (15 percent).[3]

Isom explained that "in today's high-risk investment environment, North America's relative fiscal health and growth rate make it a profitable investment destination. The European debt crisis is creating many opportunities and those seeking growth are always attracted to emerging markets."

[3] Multiple responses permitted.

Due Diligence and Lack of Opportunities Challenge Deal Makers

In terms of due diligence, respondents said that their greater challenges were presented by the assessment of volatility for future revenue streams (34 percent). Other important due diligence challenges included assessing a target's quality of earnings (19 percent), assessing the quality of a target's assets (11 percent), diligence issues surrounding the cost synergy analysis (9 percent), and the cultural assessment of the target (9 percent).

Tax issues should also be considered as early as possible, according to Lisa Madden, KPMG's Leader M&A Tax. "An important part of any deal is an analysis of tax issues and implications," she said. "The tax landscape is constantly evolving as the government issues new regulations, and buyers and sellers need to be aware of how any possible changes may affect deal structures and future profitability." The vast majority of respondents said that they do consider tax implications at the outset of a deal (70 percent). Another 26 percent said that tax issues are considered after key deal terms and structures are decided. A large percentage of respondents (39 percent) said that tax considerations make deals more complex and challenging to tackle.

Similarly, integration issues also present significant challenges and should be considered as early as possible. The most significant integration issues for respondents were cultural and human resources issues (30 percent), followed by product and services integration and rationalization (20 percent), accounting and finance transformation (12 percent), and customer and supplier integration and rationalization (11 percent).

Despite general optimism about activity levels in the coming year, respondents were very conscious of existing challenges. Almost one-third (32 percent) of survey respondents said that they thought deal activity would be most inhibited by a lack of suitable opportunities. Other issues that they thought would slow deal flow included recessionary fears and the current slow growth environment (29 percent), regulatory considerations (18 percent), and the availability or cost of debt financing (12 percent).

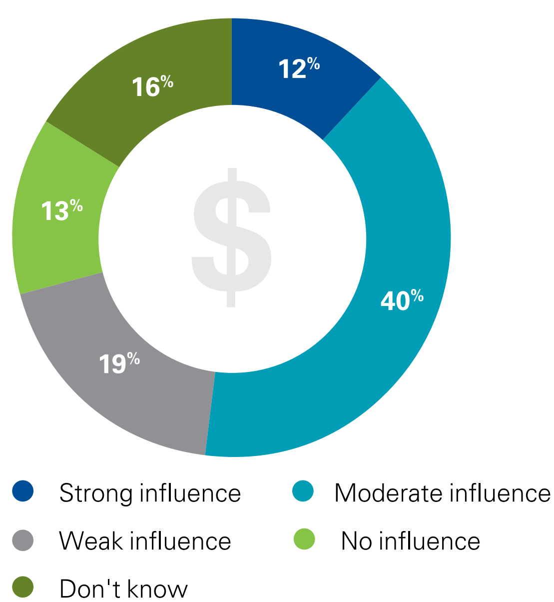
Deal Makers Consider Government Actions

How do the actions of the Federal Reserve affect the decision to raise capital? According to respondents, 40 percent said that Fed policy had a "moderate" effect; 32 percent thought Fed policy had a "weak" or no effect on the decision to raise capital or refinance.

The anticipated increase in interest rates was also not expected to have a clear-cut impact on M&A. Over half (53 percent) said it was too early to tell, 30 percent said higher rates would not affect deals, and 17 percent said they thought deal volume would decrease. In our survey, 39 percent of respondents said that they were not sure if they would be accessing the credit markets in 2014; 36 percent said that they were planning to and 19 percent said that they would not.

Interestingly, almost half of respondents (50 percent) did not think that reduced government spending would have any impact on M&A. The same percentage of respondents thought reduced spending would cause acquisitions to increase (9 percent) as to decrease (9 percent).

Q: How much influence does the Federal Reserve's monetary policy have on your decision to raise or refinance capital? Please select one choice.



Corporate Buyers Have a Slight Edge

When asked who would have an advantage in 2014, corporate buyers or PE funds, 33 percent of respondents said that they thought corporate buyers would have an advantage, 28 percent said they thought PE buyers would have an advantage, and 19 percent said they did not think either one would have an advantage.

Respondents noted that they thought corporate buyers had the advantage because they were able to pay a higher price due to their ability to realize synergies. They also noted that corporations had large amounts of cash and the increased value of their stock to use as currency.

Respondents overwhelmingly (61 percent) thought that a sale to a strategic buyer would be the preferred exit strategy for a seller. Seventeen percent said that they thought the sale to a financial buyer was preferred, 12 percent said an IPO was the preferred exit, and 11 percent believed that it was preferable to refinance or raise debt capital.

Q: Who will have more of an advantage in 2014—corporate buyers or private equity buyers?

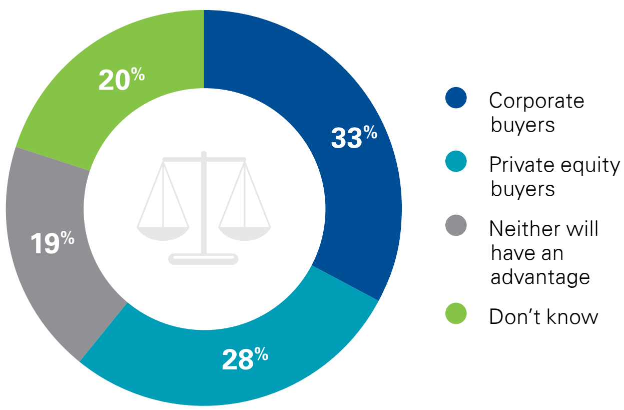
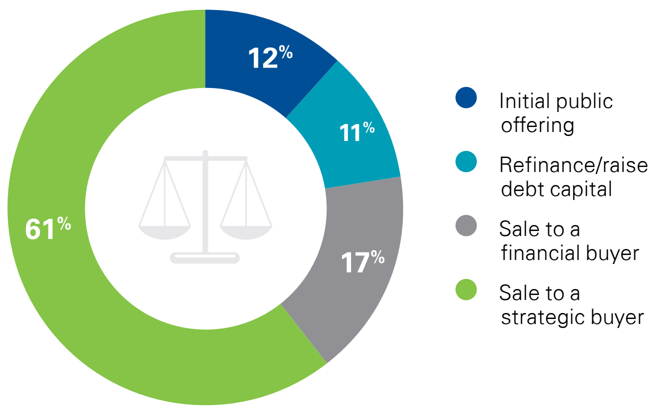


Chart percentages may not sum to 100 percent due to rounding.

Q: Which exit strategy will be most preferred by companies in 2014?



Conclusion

Corporations and PE funds have large amounts of investable capital and executives feel relatively positive about the current deal environment. Interest rates are low, the U.S. economy is improving, and global issues such as the European debt crisis are being resolved. Despite these factors, M&A has not been as active as expected in 2013. However, the executives in our survey expect deal making to pick up and expect to seek growth opportunities through acquisitions in 2014. As the M&A market improves, acquirers still face due diligence challenges in assessing targets' volatile revenue streams, quality of earnings, and quality of assets. Therefore, a robust due diligence and integration process is needed to make sure these acquisitions add stakeholder value.

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