



cutting through complexity

2015 M&A Outlook Survey Report

The Boom is Back: M&A Reemerges as Leading Growth Strategy

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Foreword

M&A in the U.S. has finally reached pre-recession levels. Deal value in the first three quarters of 2014 reached almost \$1 trillion. The 5,843 deals announced during the period are among the highest on record and represent a seven percent increase in volume and a 33 percent increase in value from 2013.¹ The current deal environment is characterized by a large number of mega-deals, including the \$71 billion consolidation by Kinder Morgan Inc. of several related entities and the \$43 billion acquisition of Covidien Plc. by Medtronic Inc. It appears that deal-makers are willing to pay a significant amount for targets that meet their strategic and growth objectives.

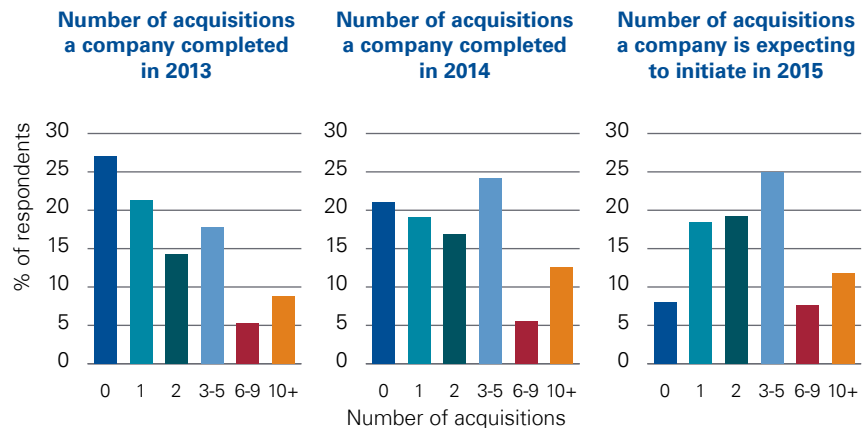
Despite global concerns, U.S. deal makers are encouraged by low interest rates, record stock prices, improving employment numbers, and an abundance of cash.

In order to gain a more precise understanding of where the M&A market is heading, KPMG and *Mergers & Acquisitions* magazine have conducted a survey of over 735 M&A professionals from U.S. corporations, private equity (PE) firms, and investment banks. Survey respondents mirrored an optimistic marketplace and also indicated they would be active investors in the year ahead. Seventy-nine percent of respondents said their companies or funds had made at least one acquisition in 2014 (compared to 66 percent last year); 17 percent said they had made two acquisitions; 12 percent said they made three acquisitions; and a very acquisitive 13 percent said they made ten or more acquisitions this year.

¹ Thomson Reuters.

Acquisition momentum is building

Anticipating that economic and market conditions will remain positive in the U.S., an impressive 82 percent of respondents said they were planning at least one acquisition in 2015; 19 percent planned to make two acquisitions; 11 percent planned three acquisitions and ten percent planned 11 or more deals for the coming year. Respondents plan on doing multiple deals in 2015, reporting considerably more expected acquisitions than in previous years.

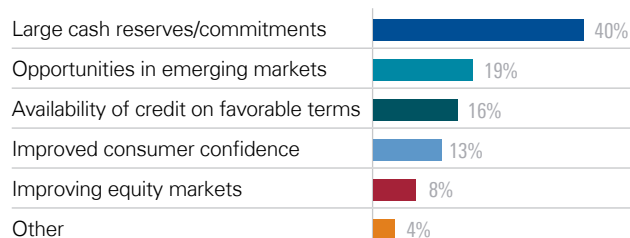


Source: KPMG Research

Survey results point to several macro-economic factors facilitating M&A activity in the coming year. Dan Tiemann, KPMG's National Leader, Transactions & Restructuring, explains, "With growing consumer confidence, favorable credit markets, and limited prospects for organic growth, U.S. companies and sponsors are very comfortable using their balance sheet cash and private equity dry powder to achieve growth through acquisitions."



Q. Which factor do you think will most drive deal activity in 2015?



Deals will increase because there is “a lot of dry powder and very favorable financing,” according to one deal advisor.

Strategic opportunities motivate buyers

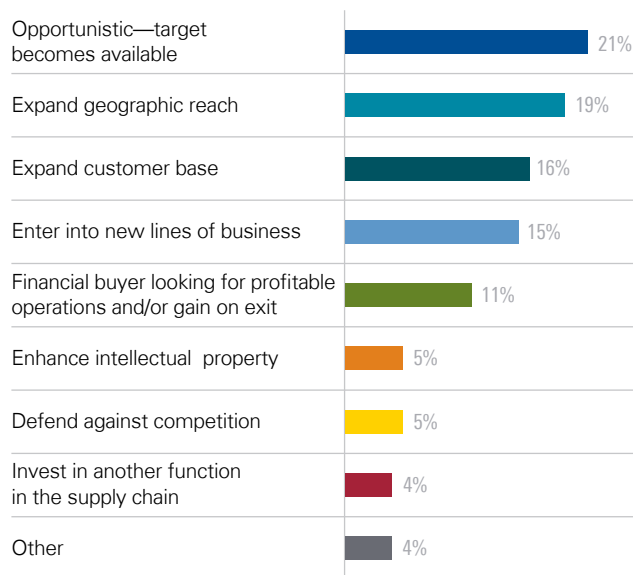
U.S. companies are always on the lookout for growth. In order to find the right targets, 35 percent of respondents review their portfolio of business units, products, and/or assets for potential acquisition targets on a monthly basis and 27 percent do so quarterly.

Interestingly, when asked what exit strategies companies will prefer in 2015, 64 percent said a sale to a strategic buyer. About 18 percent thought the preferred exit would be a sale to a financial buyer, 10 percent cited an IPO, and 8 percent said companies would choose to refinance or raise debt. However, PE funds do expect to be active in the coming year and 85 percent of those surveyed expect to make at least one investment next year. Marc Moyers, KPMG’s National Sector Leader for Private Equity, says “PE investors are encouraged by today’s general economic trends, favorable debt terms and available capital. The challenge PE investors face is sourcing quality assets at a reasonable price to generate meaningful returns.”

In 2014, global deal value increased at a much higher rate than deal volume, largely caused by a large number of mega-deals. When asked about this phenomenon, several respondents noted that acquirers have learned the lessons of the past and are paying more attention to finding the right strategic fit. As one technology investment advisor noted, “We are seeing clients be more selective with their targets. Hence, while the deal volume has not increased as anticipated, they are willing to pay a premium for targets that meet their selection criteria/growth plans.” An industrial manufacturing executive noted that “companies are getting more cautious on the quality of deals; quality trumps quantity as investors also get more critical and request more robust growth strategies.”



Q. What is the primary reason for the acquisitions you intend to initiate in 2015?



Despite the enthusiasm for M&A, respondents also intend to pursue additional strategies to increase revenues moving forward. The largest percentage (38 percent), plan to increase revenues through new product development. A significant percentage (28 percent) intend to use geographic expansion or plan to enter new market segments (18 percent).

Deal value expected to climb

Despite the large, headline grabbing deals, such as Facebook's \$19 billion acquisition of WhatsApp, most respondents continue to believe that the M&A environment will be dominated by smaller and middle-market deals. However, deal values are expected to increase from last year. For their companies, 50 percent of all respondents said that the average enterprise value per acquisition would be less than \$250 million. About 27 percent said they anticipated average deal value to be between \$250 million and \$499 million, 16 percent anticipated average deal value to be between \$500 million and \$999 million, six percent thought average deal value would be between \$1 billion and \$5 billion, and less than one percent expected average deal value to be greater than \$5 billion. Interestingly, in last year's survey, 77 percent of respondents said they thought the average enterprise values for their acquisitions would be less than \$250 million. Deals are getting larger, in part, because corporate profits and corresponding valuations are increasing.

Phil Cioffi, the National Leader of M&A Tax at KPMG, agrees that tax issues remain complex. "Understanding and addressing tax issues as early as possible in the deal process can have a significantly positive effect on deal values," he says. "Do not wait until key deal terms are set. Acquirers should not lose an opportunity to address tax risks and implement the most efficient acquisition structure and most effective post-acquisition integration process."

Deal risks require focus

As deal size increases, the risks associated with deal success become more significant. When asked which factor was most important for success, the largest percentage of respondents (43 percent) cited a well-executed integration plan. "Developing a 100 day plan with a road map for the first few months can greatly improve integration results and enhance the chances of deal success," says KPMG's Tiemann. Other important criteria were correctly valuing the deal (26 percent) and having an effective due diligence plan (18 percent). In terms of integration, the most challenging issues included cultural and human resources issues (53 percent), products and services integration and rationalization (32 percent), accounting and finance transformation (25 percent), and customer and supplier integration and rationalization (23 percent). The most consistently challenging due diligence issues included assessing future revenue streams (51 percent), issues surrounding the quality of earnings (42 percent), cultural and HR issues (28 percent), and cost synergy analysis and quality of assets (both 24 percent).²

Divestitures pose their own set of challenges. According to respondents, the most important separation issue that arises during a divestiture is clarifying the operational links/entanglements (28 percent). Other key separation issues included understanding the deal parameters (17 percent), agreeing on the scope of the transition services agreement (16 percent), and helping the buyer quantify stand-alone costs (13 percent). Tiemann notes, "Buyers should be aware that data driven due diligence can mitigate many challenges, including execution issues. Additionally, sellers can use a data driven analysis to enhance the sales process, obtain a higher sales price, and minimize value loss post-close."

Tax implications have had a significant impact on some of this year's larger deals, remain important and should always be considered as early as possible to increase deal benefits. The vast majority of survey respondents (70 percent) said that they do consider tax issues from the outset. About 26 percent look at tax implications after key deal terms have been structured and just four percent said they do not consider tax issues at all. About 42 percent of executives thought that tax issues were currently about the same in terms of level of complexity, but 39 percent thought there were more tax "traps" for the unwary.

² Multiple responses permitted.



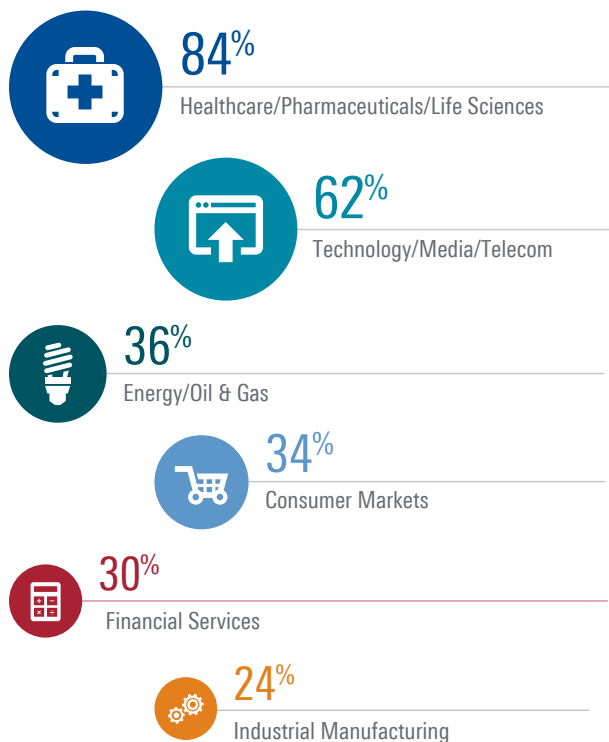
Industry trends and challenges

Not surprisingly, the industries that were expected to be the most active in terms of M&A are those that are undergoing the most transformation.

Q: Which industries do you think will be the most active in M&A in 2015?

Respondents predict that the most active industry will be healthcare related (84 percent). Other industries that were expected to dominate deal making include technology/media/telecom (62 percent), energy, oil & gas (36 percent), and consumer markets (34 percent).³

Predicted M&A by Industry



Each industry is dealing with its own specialized deal environment, as well as industry-specific challenges and opportunities.

³ Similarly, last year, the most active industries were predicted to be technology/media/telecom, healthcare/pharmaceuticals/life sciences, financial services, and energy. According to Mergermarket, for the first three quarters of 2014, deals were dominated by energy, mining and utilities, consumer markets, industrials and chemicals, financial services, and technology.



Healthcare

As expected, an extremely large percentage of healthcare sector respondents (74 percent) said that the industry response to the Affordable Care Act would be the most significant driver for next year's deal activity. Other important drivers were consolidation of core businesses/competition (45 percent) and the need for consumer growth (26 percent). The most active healthcare subsectors are anticipated to be hospitals (66 percent), managed care (37 percent), diagnostics (21 percent), and pharmaceuticals/biotechnology (21 percent). The most challenging issues for deal makers in this sector include regulatory/political issues, the ability to identify suitable targets, and valuation disparities between buyers and sellers (all at 42 percent).⁴



Technology

The key trends that will drive M&A in this sector include mobile technology (54 percent), cloud (48 percent), data analytics (47 percent), and security (38 percent). Beyond increasing revenues and cutting costs, the primary motivators for technology deals are access to intellectual property and/or talent (50 percent), bolt on acquisitions to enhance new products (42 percent), the acquisition of innovative technologies or products (41 percent), the desire to enter into markets (41 percent), and the desire to expand existing technology platforms (40 percent). The technology executives in the survey overwhelmingly said that the most common challenge to deal making in the year ahead was the valuation disparity between buyers and sellers (67 percent). They were also concerned with the identification of suitable targets (39 percent) and the buyer/target alignment on post-deal execution strategy (25 percent).



Energy

Energy respondents said that deals in their sector were being driven by the consolidation of core businesses and a response to competition (54 percent), the need for geographic growth (39 percent), and the need for new technologies and product and service growth (both 35 percent). The most common M&A challenges are anticipated to be uncertainty in the regulatory environment (48 percent), valuation disparities between buyers and sellers (46 percent), the ability to forecast future performance (35 percent), and volatile energy prices (33 percent).



Consumer Markets

Consumer markets respondents believe that the most important M&A trends are consolidation and the response to competition (41 percent), the need for product and service growth (39 percent), and the need for customer growth (36 percent). In terms of divestiture activity, the key trends are the opportunity to sell a non-core business (58 percent), the opportunity to monetize a successful business (43 percent), and the opportunity to sell an unprofitable business (30 percent). The biggest challenges are anticipated to be valuation disparities between buyers and sellers (52 percent), the identification of suitable targets (30 percent), and the ability to forecast future performance (27 percent).



Financial Services

Executives in this sector said that the most important trends driving M&A will be the need for customer growth (42 percent), increasing regulations that favor scale (40 percent), and the need to consolidate core businesses or respond to competition (38 percent). The financial subsectors that are expected to be most attractive include: financial technology (26 percent), banking (21 percent), and insurance (17 percent). The financial services industry continues to receive increased government attention and executives said the number one challenge for dealmakers was uncertainty in the regulatory environment and increased government scrutiny (58 percent). They also cited valuation disparities between buyers and sellers (50 percent) and the identification of suitable targets (40 percent).



Industrial Manufacturing

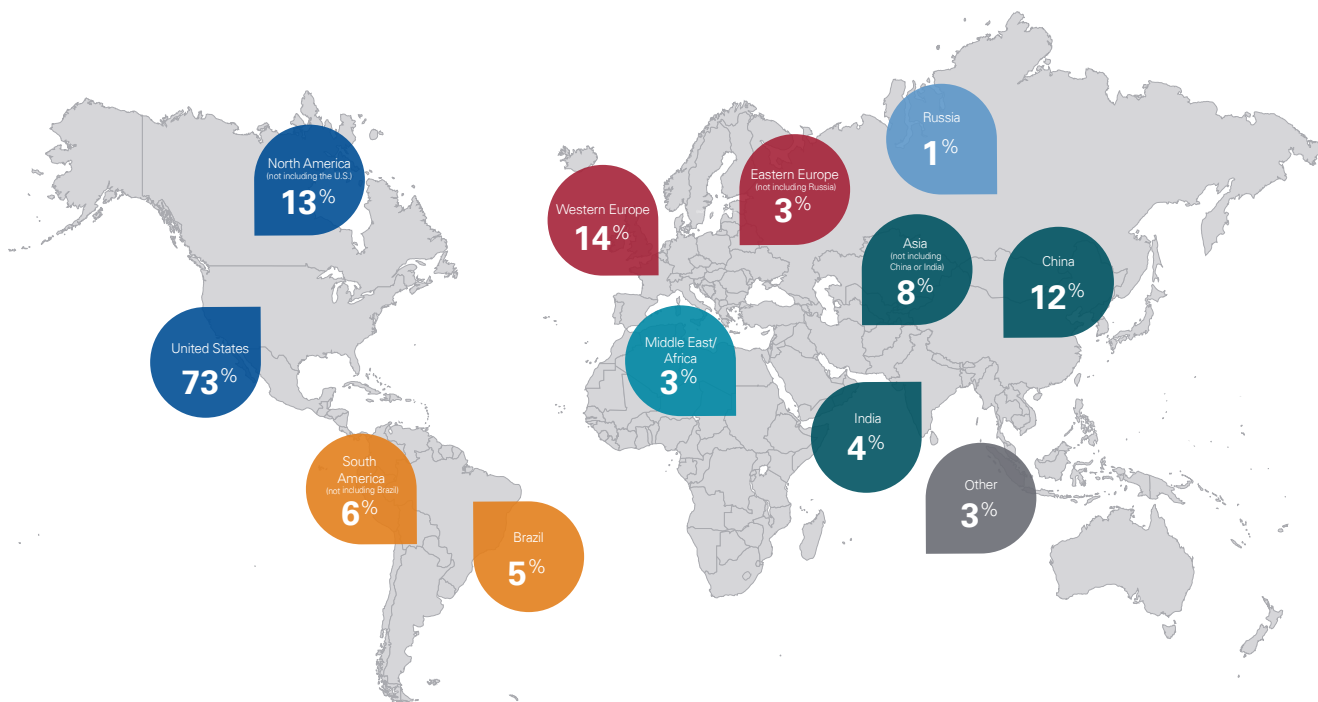
Respondents in industrial manufacturing said the main trends driving acquisition activity will be the need for market access (51 percent), the need for technology advancement (31 percent), and the need to cut costs (28 percent). Divestitures will be driven by the opportunity to sell non-core businesses (73 percent), the opportunity to monetize a successful business (38 percent), and the opportunity to sell an unprofitable business (32 percent). The most common challenges to deal making are anticipated to be a valuation disparity between buyers and sellers (61 percent), the challenges of identifying suitable targets (39 percent), and the difficulty of forecasting future performance (36 percent).

⁴ Multiple responses permitted.



U.S. expected to lead deal activity

Q: In which regions/countries will you primarily invest in 2015?



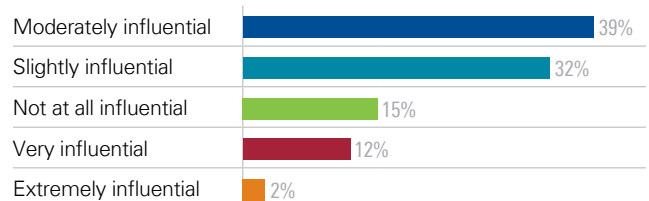
To date, this year the U.S. received over 44 percent of global deal value—one of the largest shares on record. Investors are attracted to the U.S.’s relatively healthy growth rate, improving economy, and open credit markets. Respondents also expect the U.S. to be a popular deal destination in the next year. Phil Isom, KPMG’s Global Head of M&A, commented, “although acquirers are always focused on cross-border opportunities, global uncertainty is impacting investment decisions. While U.S. markets remain attractive and stable versus other options, the continued strengthening of the U.S. dollar may negatively impact foreign buyers looking for assets in the U.S.”

Government monetary policy only moderately important

While headlines concerning interest rates and Fed policy are a constant, survey respondents said that government policy has only a limited impact on their deal strategies. When asked how the anticipated increase in interest rates would affect M&A in the next two years, 46 percent said that it was too early to tell, 34 percent said there would be no meaningful effect, and 20 percent thought deal volume would decrease. The importance of the Federal Reserve's monetary policy on a company or fund's decision to raise or refinance capital is also mixed. Thirty-nine percent of respondents said Fed policy was moderately influential, 32 percent thought it was slightly influential, and 15 percent said it had no influence.



Q: How influential is the Federal Reserve's monetary policy in your decision to raise or refinance capital?



Over half (54 percent) of respondents expect interest rates to increase in the second half of next year; 23 percent expect rates to increase in the first half of 2015 or in 2016. The current low rate environment has had a positive effect on the stock market; the S&P 500 celebrated multiple record closing prices this year. Is the current market overpriced? The answer is "yes," according to a majority of respondents. Fifty-nine percent of respondents thought so, in contrast to the 41 percent who disagreed. In sum added, "The capital and debt markets outlook remains positive and M&A activity has still not consumed the significant amount of liquidity in the debt markets. This liquidity is leading to lower borrowing costs and more flexible debt packages for M&A transactions, which is supporting accelerated M&A growth in the market."

Conclusion

M&A professionals have waited for several years for the malaise of the recession to pass. It appears that in 2014, deal makers embraced M&A with enthusiasm, and respondents expect 2015 to also be an extremely active year. The fundamentals of healthy credit markets, abundant cash reserves and improving employment numbers all indicate that respondents should be right. Despite the enthusiasm, deal makers recognize that successful deals require superior strategies, comprehensive due diligence, and well-developed integration plans. Once these very complex processes have occurred, deal makers should be on their way to increasing shareholder and investor returns through acquisitions.



About KPMG's M&A Practice

We have structured our approach through an investor's lens to help ensure we are focused on those same characteristics to help our clients identify, evaluate, and successfully implement growth strategies. We use techniques such as benchmarking, strategic profitability insights, and other data and analytics techniques in order to help clients sort through the vast amount of information from a potential target and the marketplace. KPMG's Transactions and Restructuring practice assists clients with evaluation and execution of investments, including M&A transactions, from pre-deal planning and target identification to due diligence and business integration.

Every transaction has tax implications. Whether you are contemplating an acquisition, disposition, merger, or restructuring, understanding and planning

for these implications can mitigate transaction risks and enhance opportunities. KPMG's M&A Tax practice assists clients by creating tax efficiencies throughout the life cycle of a client's business.

The private equity industry has become a significant alternative to capital market investments. Value enhancement, performance improvement, and accountability of existing assets have raised the bar for firms to achieve excellence beyond financial engineering. KPMG's Private Equity practice can assist with the unique challenges the industry faces and help deliver on critical aspects of the private equity cycle. The depth of KPMG's Private Equity practice's experience and global network of professionals allows us to be a meaningful value-added partner to our fund clients and their portfolios on an array of service capabilities.

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