Four Industries That Are Expected to Dominate M&A in 2014

According to a recent survey of over 1,000 executives conducted by KPMG, in conjunction with *Mergers & Acquisitions* magazine, four industries are expected to be the most active in terms of M&A. 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).[1] To gain added insight into the M&A prospects of these industries, KPMG analyzed how M&A professionals in each of these industries perceived the year ahead.

Technology/Media/Telecom

A large percentage of technology companies (68 percent) said they were planning at least one acquisition in 2014. Middle-market deals are expected to predominate in this sector and 82 percent of the tech executives surveyed said their acquisitions would be valued at less than $250 million. These companies were motivated most by a desire to expand their customer base (22 percent), enhance intellectual property (16 percent) and expand into a new line of business (16 percent). Interestingly, 73 percent of tech executives said they thought technology, media and telecom would be the most active industries for M&A in 2014. One tech executive said he thought acquisitions would increase because "the market was consolidating and there was a war for talent." Another said his company would increase activity because his company's "balance sheet was in order and he could now focus more on growth;" another summed up his company's motivation with the words "appetite, focus and opportunity."

> "Technology companies are seeking to acquire talent and intellectual property as part of a broader mobile and cloud strategy. I think we are going to see a lot of consolidation in this space as companies are focusing on growth opportunities," according to KPMG's Chad Seiler.

In terms of geographic activity, technology executives expect the U.S. to be the most active place for their deals (62 percent), followed by Western Europe (35 percent) and China (28 percent).[2] M&A professionals in technology, media and telecom said that the most important trends driving M&A will be converging technologies (52 percent), cloud computing (43 percent), data analytics (43 percent), mobility (43 percent) and social networking (20 percent).[3] Deal making in this sector is 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).[4] The most challenging due diligence issues were assessing future revenue streams (35 percent) and evaluating the quality of both assets and earnings (both 13 percent).

[1] Multiple responses permitted.
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[3] Multiple responses permitted.
[4] Multiple responses permitted.

Healthcare/Pharmaceuticals and Life Sciences

Sixty-nine percent of healthcare executives said that they were planning an acquisition in 2014. In this sector, middle-market deals were also expected to dominate and 77 percent said their deals would be valued at $250 million or less. Executives in this sector said they were motivated by a desire to expand their geographic reach (19 percent), introduce new products and expand their customer base (both 18 percent). Favoring their own industry, 79 percent of healthcare executives said that they thought their own sector would be the most active in terms of M&A in 2014. Several M&A professionals said activity would be motivated by a need for "consolidation in the industry" and one added that his company was responding to "rapid growth and innovation in the industry."

> KPMG's Bill Baker says, "with the Healthcare industry undergoing a substantial transition driven by regulatory and legislative mandates, we are seeing a convergence of the provider and payor sectors primarily through mergers and acquisitions. We expect the convergence to continue over the next decade as requirements to operate more cost effectively will result in continued consolidation."

Healthcare executives thought the most active geographic areas would overwhelmingly be the United States (67 percent), followed by China (36 percent) and Western Europe (34 percent).[5] Not surprisingly, the number one trend behind M&A in this sector was expected to be the industry's 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).[6] 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).[7] The industry's most challenging due diligence issues are the ability to assess future revenue streams (39 percent), quality of earnings (22 percent) and cultural and H.R. issues (13 percent).

Financial Services

Almost 50 percent of financial services executives said they would be acquirers in 2014 and 71 percent said they would be doing deals valued at less than $250 million. Deals would be motivated by a desire to expand geographic reach (17 percent), enter into a new line of business (15 percent) and expand their customer base (13 percent). Fifty-six percent predicted that their own sector would be the most active. Several of those surveyed noted the need to consolidate. As one FS professional explained, "the market is driving more opportunities. More regulations are causing small institutions to understand they can't generate the return on equity to their shareholders, so their best option is to merge with a larger institution."

> Regulatory issues are a primary concern for financial service professionals, according to KPMG's Tim Johnson. He says, "We are seeing these increasing requirements motivate deals and create the need for scale. However, the evolving regulatory environment also poses challenges in the form of more stringent approvals and oversights. Therefore, those pursuing acquisitions need to simultaneously consider both these added costs and perceived benefits during the due diligence stages of a deal."

Financial Services executives expect to see the most M&A in the U.S. (53 percent) and Western Europe (28 percent).[8] 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).[9] 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).[10] 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).[11] The most difficult due diligences for this sector include assessing future revenue

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streams (24 percent), assessing a target's quality of assets (20 percent) and quality of earnings (12 percent).

Oil & Gas

About 56 percent of those surveyed said that their companies would be initiating an acquisition in 2014. Middle-market deals were expected to dominate, but energy executives predicted slightly larger deal sizes. Fifty-six percent said their deals would be valued at less than $250 million, 23 percent said they would be valued between $250 million and $499 billion and 11 percent expected their deals to be valued at between $500 million and $999 million. Their primary reason for doing a deal was to expand their geographic reach (25 percent) and to expand their customer base (14 percent). A substantial 57 percent predicted that their own industry would be most active. Executives said they were motivated by a desire for growth. One executive said his company had a "need for top-line growth in sluggish economic environment," and another explained he was seeing "more opportunities and less competition."

> KPMG's Anthony Bohnert says, "we continue to see companies rebalancing their asset exposure, concentrating development resources in liquid rich plays and areas with adequate midstream infrastructure, logisitics and market access to support near term profitability and growth. Additionally, continued uncertainty around state and federal environmental regulations and local 'political will' around future development remain considerations for companies as they look to emerging plays."

Oil & Gas executives predicted that the most attractive destinations for deal making would be the U.S. (57 percent), followed by Western Europe (27 percent) and China (26 percent).[12] According to oil & gas respondents, the most important trends driving M&A in this sector will be consolidation (56 percent); new technologies, including fracking (52 percent); geographic growth (35 percent); product/service growth (18 percent); and customer growth (13 percent).[13] 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).[14]

Conclusion

It is not surprising that respondents expected technology, healthcare, financial services and energy to be among the most active sectors in 2014. New technologies continue to fuel growth and eager investors are interested in purchasing intellectual property, new products and new customers. Like technology, the energy sector has been able to harness advanced processes to greatly transform itself and, in the process, has created numerous investment opportunities. Additionally, an evolving regulatory environment for healthcare and financial services has created opportunities for service expansion and consolidation.

In addition to their perceived attraction for deal-makers, these sectors share many characteristics including a preference for smaller deals, challenges surrounding valuation and a difficulty in predicting future revenue streams. Each sector, however, does require its own approach to deal-making and an individualized focus on industry-specific due diligence is needed.

[12] Multiple responses permitted.

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