KPMG

# U.S. executives on M&A: full speed ahead in 2016

2016

Survey findings

FORTUNE Knowledge Group

**Last year was the biggest ever for U.S. mergers and acquisitions. By year end, $4.7 trillion of global deals were signed, topping 2007's previous record for deal value. What will 2016 be like for deal-makers?**

KPMG

# Foreword

Many factors contributed to 2015 being one of the best M&A years on record in the U.S., including, an improving economy, strong stock market and cash-heavy balance sheets. Looking ahead, what will 2016 be like for deal-makers?

Numerous factors indicate that the high level of activity in 2015 will carry over into 2016. As U.S. companies continue their quest for growth, they continue to be faced with a buy versus build strategy. Many companies are choosing to include M&A as an integral part of their strategy. We believe the M&A activity will be most significant in those industries (Technology and Life Sciences) where the market disruption is the most significant. However this is all relative, as many industries are facing their own disruptive forces.

To gain added insight and to help our clients look forward, we surveyed over 550 deal executives to get their perspectives. We are proud to present the tenth annual forward looking M&A outlook survey "U.S. executives on M&A: full speed ahead in 2016." We hope this helps you as you look forward into the new year.

Daniel Tiemann

U.S. Group Leader,
Deal Advisory and Strategy

KPMG LLP

# Full speed ahead in 2016

Last year was the biggest ever for U.S. mergers and acquisitions. By year end, $4.7 trillion of global deals were signed, topping 2007's previous record for deal value[1]. U.S. executives expect another banner year for deal activity in 2016, according to a survey of over 550 M&A professionals conducted by KPMG, in partnership with FORTUNE Knowledge Group (see methodology, page 23). These executives expect the number of M&A deals to accelerate and the average deal size to increase in 2016. Findings from the survey—KPMG's 10th annual study of the M&A outlook—suggest that M&A remains the preferred growth strategy.

What are the main factors driving dealmakers? And what explains the seeming resilience of M&A in the face of global political anxiety, sluggish growth across emerging markets, and uncertainty surrounding interest rates? This report seeks to provide answers to these questions at a critical moment in the global economic cycle. Megadeals appear to be on the rise. In 2015, there were nine deals valued at $50 billion or more. For example, Anheuser-Busch InBev agreed to purchase brewer SABMiller for $105 billion, and Pfizer Inc. agreed to buy Ireland-based Allergan for $160 billion to create the world's largest pharmaceutical maker. Will even bigger deals become part of the M&A landscape in 2016?

"Our survey paints a bullish outlook for M&A. In the absence of sharply destabilizing factors, the economic fundamentals suggest that M&A activity may strengthen even further in 2016," according to Dan Tiemann, U.S. Group Leader, Deal Advisory and Strategy, KPMG LLP.

**"Our survey paints a bullish outlook for M&A."**

**— Dan Tiemann, U.S. Group Leader, Deal Advisory and Strategy, KPMG LLP**

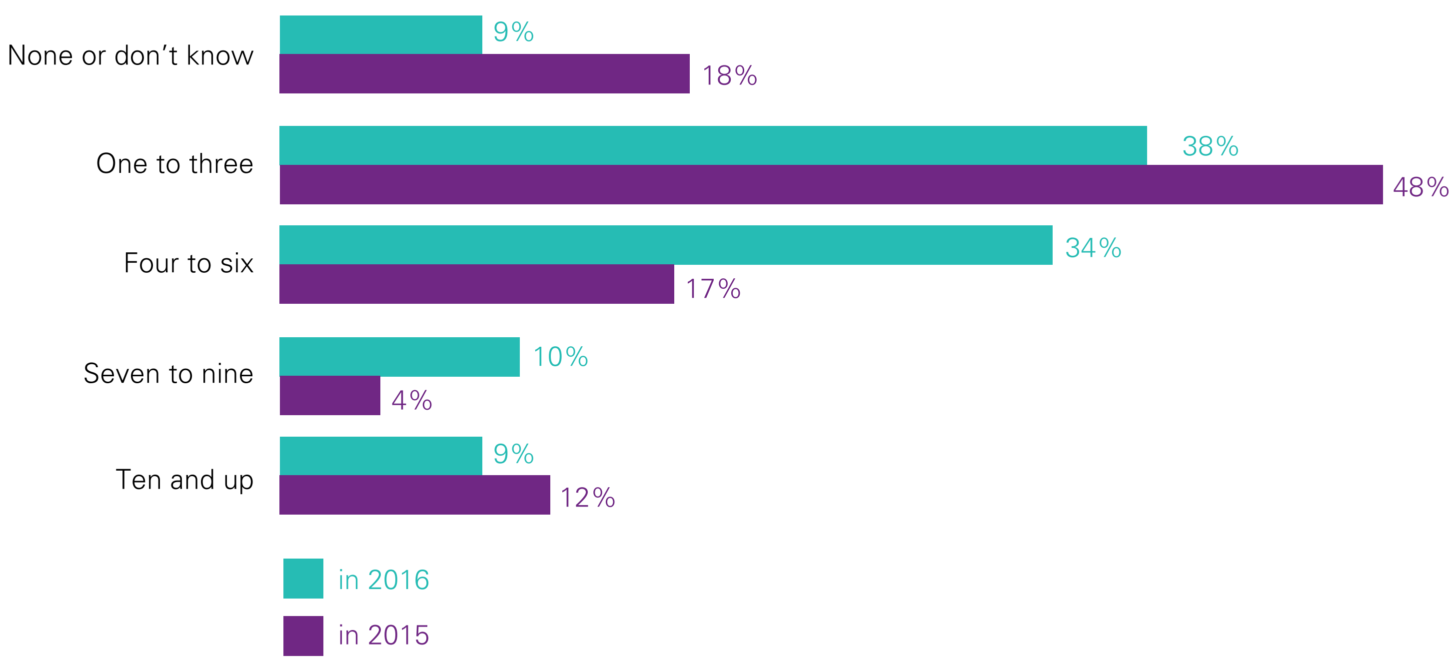
[1] Dealogic December 31, 2015

# Multiple acquisitions on corporate agendas

Survey data[2] indicates that executives expect the M&A market to be even stronger in 2016. Ninety-one percent of respondents say they intend to initiate one or more acquisitions in the next 12 months, compared with 82 percent in KPMG's survey a year ago and 63 percent the previous year. Respondents also expect to increase their number of acquisitions in 2016. Eighty-one percent anticipate executing two or more mergers, versus 64 percent in the previous survey; and 42 percent expect to initiate five or more mergers, compared with only 27 percent the previous year.

### How many acquisitions will you initiate in 2016?

(% of respondents)

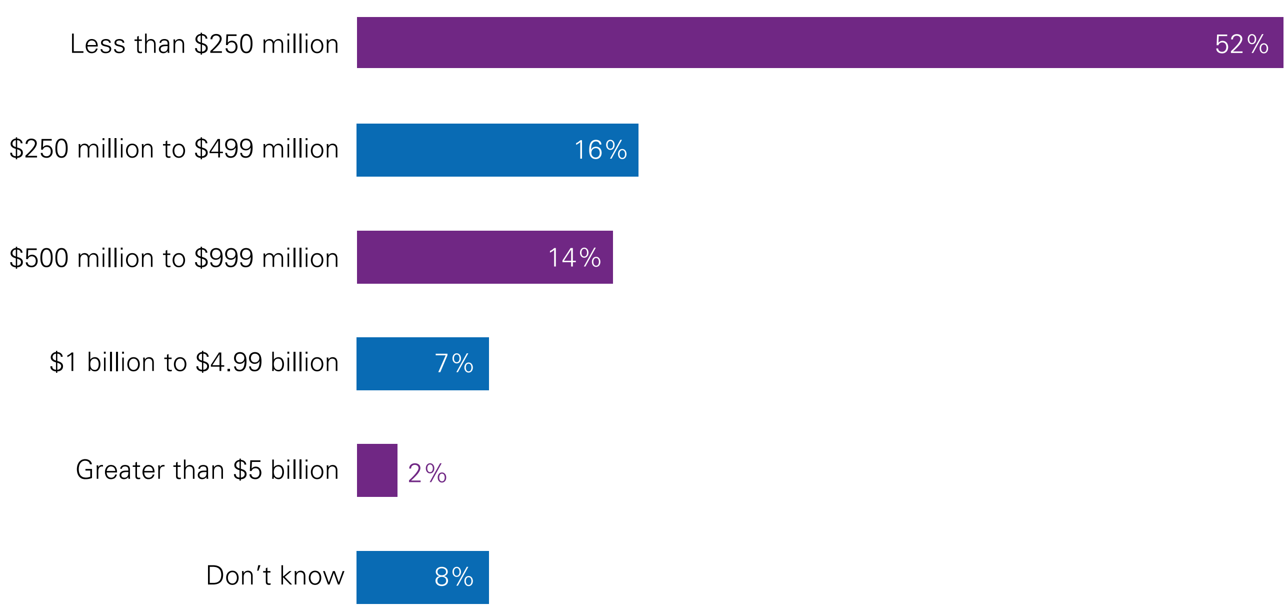



[2] *Multiple responses were permitted in questions where answers exceed 100%*

We also asked executives to estimate their average deal size. Megadeals are in the headlines, but middle-market deals are expected to dominate. Sixty-eight percent say their deals will be valued at less than $500 million; 14 percent of their deals are expected to be valued between $500 million to $999 million; and 9 percent expect their deals to exceed $1 billion.

## What do you anticipate the average enterprise value per acquisition will be?

(% of respondents)



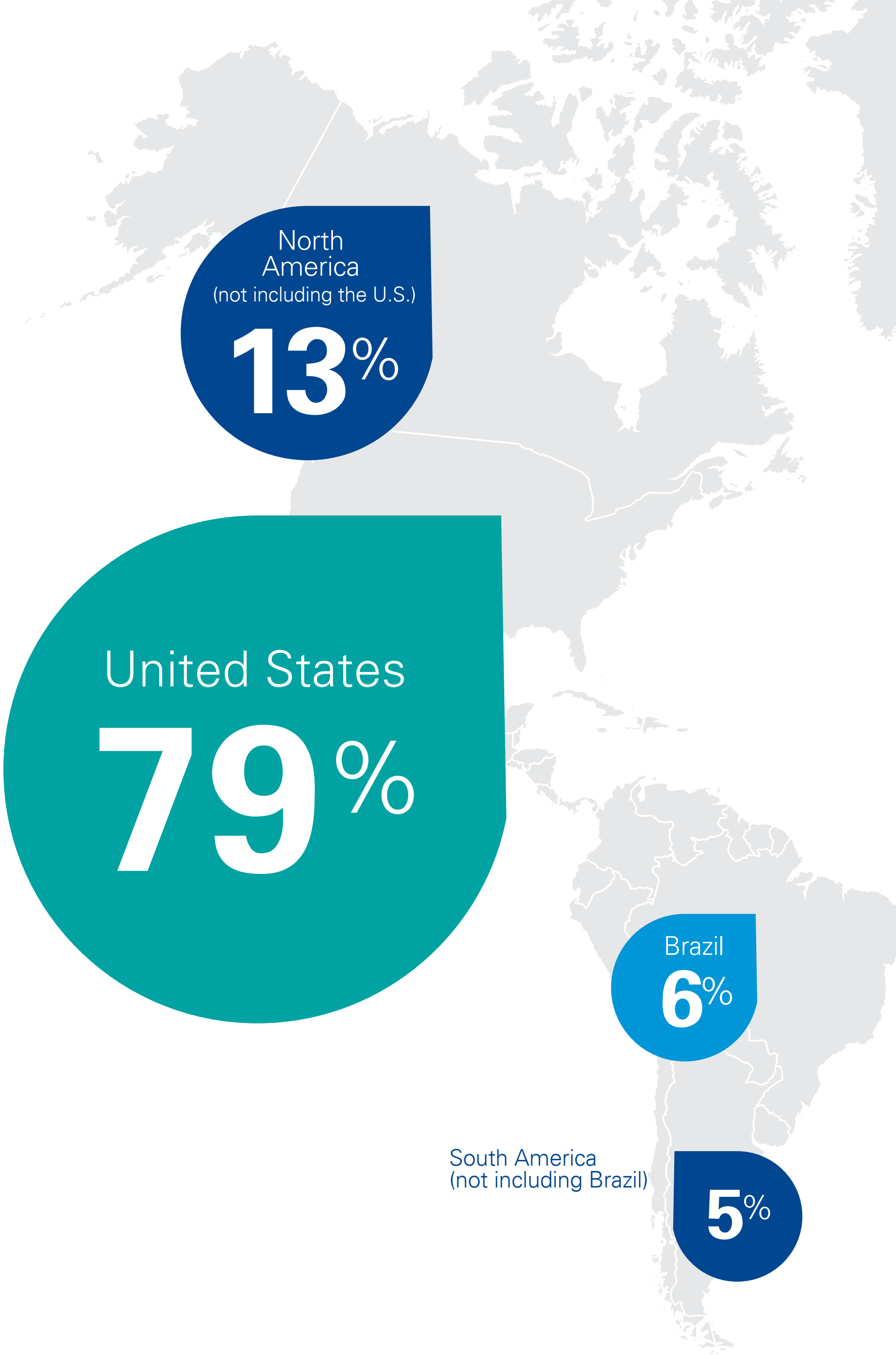

One company with a long M&A pipeline is Johnson Controls, a global multi-industrial company based in Milwaukee. M&A is vital to its strategic growth. "We probably have between 10 and 20 deals in a wide variety of sizes ongoing at any point in time," says Brian Stief, executive vice president and chief financial officer.

# U.S.: expected to lead deal activity

What geographic area do respondents think will be most active for M&A in 2016? The vast majority (79 percent) choose the U.S., which is not surprising, due to the country's relatively robust economic prospects. Other popular M&A destinations include Western Europe (21 percent) and North America excluding the U.S. (13 percent). Emerging markets, where growth has been slowing, are less popular. China, India, and the rest of Asia register between, with 10 to 11 percent.

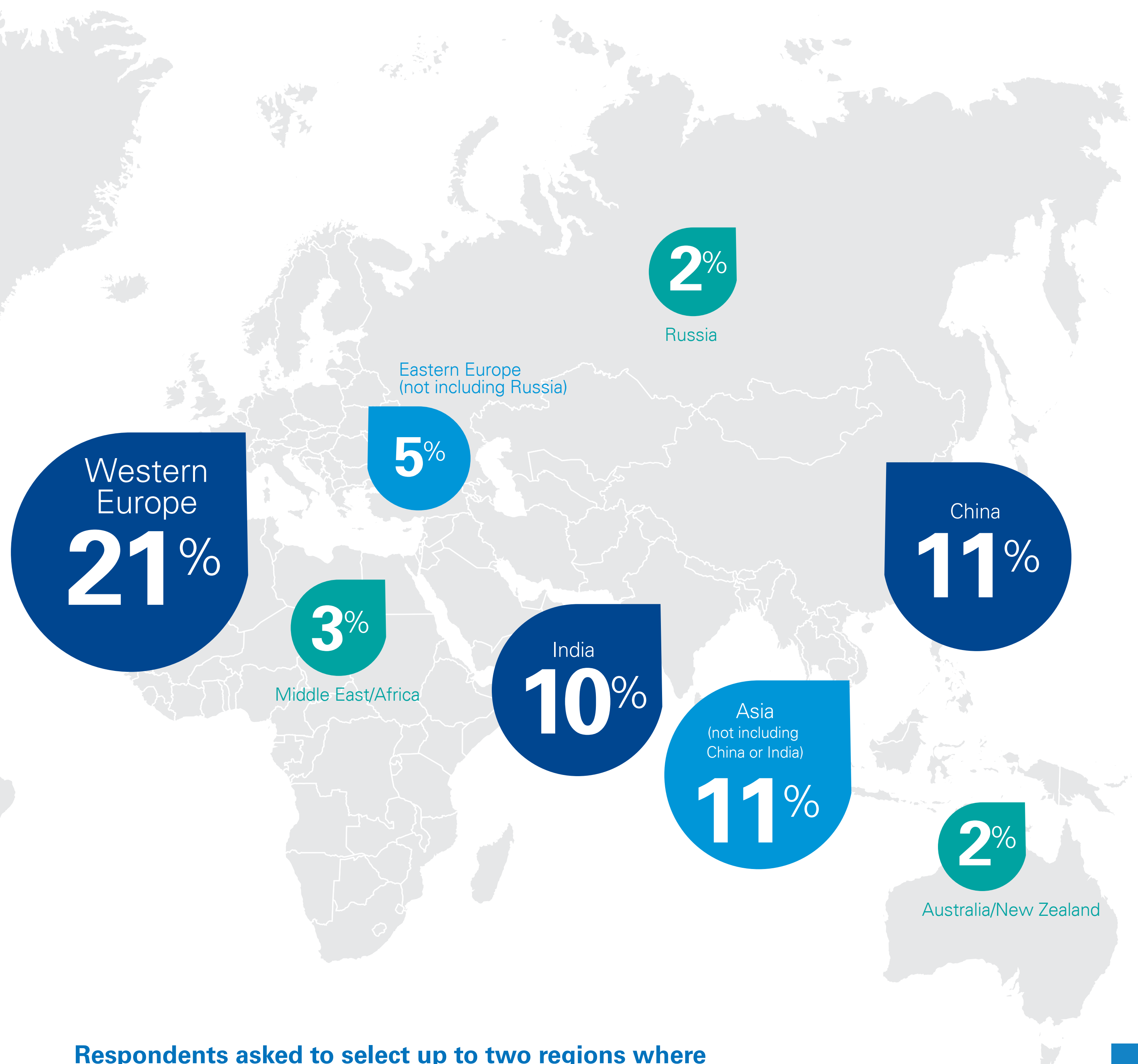
"The U.S. continues to be the favored M&A destination because of its relatively healthy economy. However, other high-growth destinations will always attract corporate and private equity capital," explains Philip Isom, Global Head of M&A, KPMG LLP. Although those growth rates have been declining, they are still amongst the highest in the world.

Currency rates were not an important factor for dealmakers; only 29 percent of respondents say the stronger dollar has increased their interest in cross-border deals, while two-thirds report no substantial impact.



## "The U.S. continues to be the favored M&A destination because of its relatively healthy economy."

**— Philip Isom, Global Head of M&A, KPMG LLP**




**Respondents asked to select up to two regions where they will primarily invest in in 2016**

# Industry trends and challenges

When asked which industry would be most active in 2016, the majority of respondents (70 percent) predicted that technology would see the most deals, followed by pharmaceuticals/biotechnology (60 percent). Health care providers (47 percent) and media/telecom (42 percent) were also expected to be among the most active.

### In your opinion, which of the following industries do you think will be most active overall in mergers and acquisitions in 2016?

(% of industry respondents, asked to select up to six)

Of course, these are the industries undergoing some of the most significant changes, which in turn create large investment opportunities for both buyers and sellers. As all industries, ranging from financial services to industrial manufacturing, seek to gain access to the latest technological advances, tech companies are also creating tremendous investment opportunities for buyers and sellers. Similarly, pharmaceutical and biotech companies are providing investors with access to products that can change their business models and alter medical outcomes. Responding to the Affordable Care Act has created M&A opportunities for health care providers, especially as scale becomes important. The media and telecom industries are responding to shifts in consumer preferences and different models for the creation and delivery of content.

## Key trends driving M&A activity in 2016 in the consumer markets sector

(% of industry respondents)


Key challenges to deal-making in the consumer markets sector

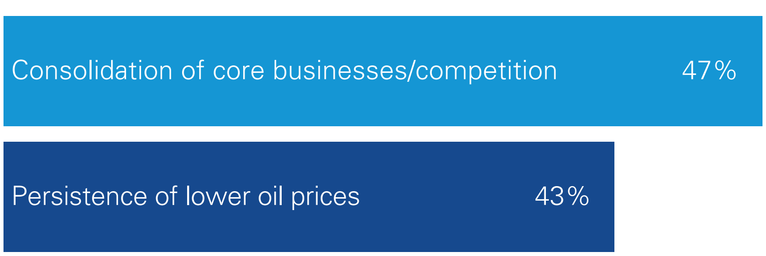
(% of industry respondents)

Valuation disparity between buyers and sellers **61%**

Identification of suitable targets **43%**

## Key trends driving M&A activity in 2016 in the energy sector

(% of industry respondents)




Key challenges to deal-making in the energy sector

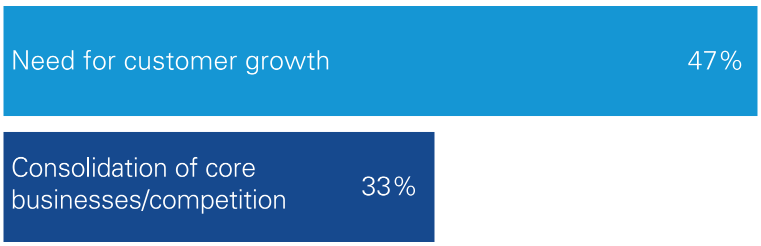
(% of industry respondents)

Valuation disparity between buyers and sellers **47%**

General economic environment (ability for forecast future performance) **42%**

## Key trends driving M&A activity in 2016 in the financial services sector

(% of industry respondents)




Key challenges to deal-making in the financial services sector

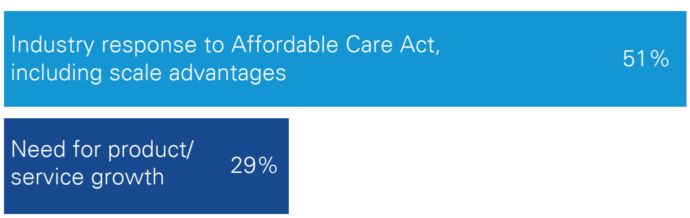
(% of industry respondents)

Valuation disparity between buyers and sellers **53%**

Uncertainty in the regulatory environment/increased government oversight **43%**

## Key trends driving M&A activity in 2016 in the healthcare sector

(% of industry respondents)




Key challenges to deal-making in the heathcare sector

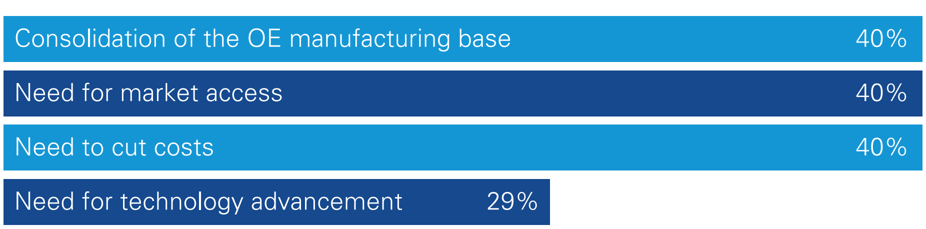
(% of industry respondents)

Valuation disparity between buyers and sellers **56%**

Identification of suitable targets **36%**

## Key trends driving M&A activity in 2016 in industrial manufacturing

(% of industry respondents)




Key challenges to deal-making in industrial manufacturing

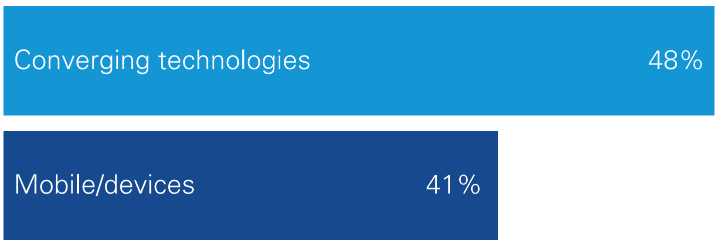
(% of industry respondents)

Valuation disparity between buyers and sellers **69%**

Identification of suitable targets **48%**

## Key trends driving M&A activity in 2016 in the media/telecommunications sector

(% of industry respondents)




Key challenges to deal-making in the media/telecommunications sector

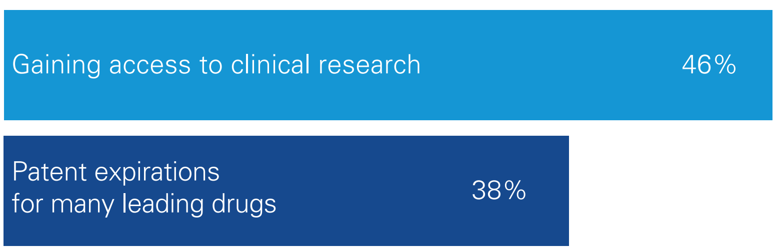
(% of industry respondents)

Valuation disparity between buyers and sellers **74%**

Key employee retention and performance incentives **41%**

## Key trends driving M&A activity in 2016 in the pharmaceuticals/biotechnology sector

(% of industry respondents)




Key challenges to deal-making in the life sciences sector

(% of industry respondents)

Valuation disparity between buyers and sellers **66%**

Identification Buyer/target alignment on post deal strategy **29%**

## Key trends driving M&A activity in 2016 in the technology sector

(% of industry respondents)


Key challenges to deal-making in the technology sector

(% of industry respondents)

Valuation disparity between buyers and sellers **63%**

Key employee retention and performance incentives **45%**

# Optimal financing conditions are likely to support deals

Executives responding to the survey appear strongly bullish about M&A in the near term. A significant 69 percent, however, say current market valuations are not sustainable. Despite high stock prices and climbing valuations among private companies, overall financial conditions for U.S. companies have rarely been as favorable for those interested in pursuing M&A. Companies have record cash reserves, which tend to immunize them against possible interest rate hikes. According to FactSet, cash reserves of the companies in the Standard and Poor's (S&P) 500 totaled $1.4 trillion in July 2015, 5.5 percent higher than a year earlier[3]. Credit markets are very healthy, and even the increase in interest rates is unlikely to have a significant impact on borrowing because rates are at historic lows.

Corporations that can put cash to work to generate profits have an incentive to pursue strategic mergers, despite high asset valuations. When asked to rank which factor executives think will most strongly drive M&A activity in 2016, by far the largest proportion (51 percent) says large cash reserves, followed by the availability of credit on favorable terms (36 percent). Improved consumer confidence is also seen as an important factor by 32 percent. PE firms were among the most active acquirers in 2015, and here, too, deal volume surpassed the banner year of 2007.

"High valuations do not rule out a robust deal flow for financial or strategic buyers. Strong cash reserves, plenty of financing on favorable terms, and record stock prices make deals possible at 10 times earnings, which could not be done when multiples were lower, " according to Gavin Geminder, U.S. National Leader, Private Equity, KPMG LLP.

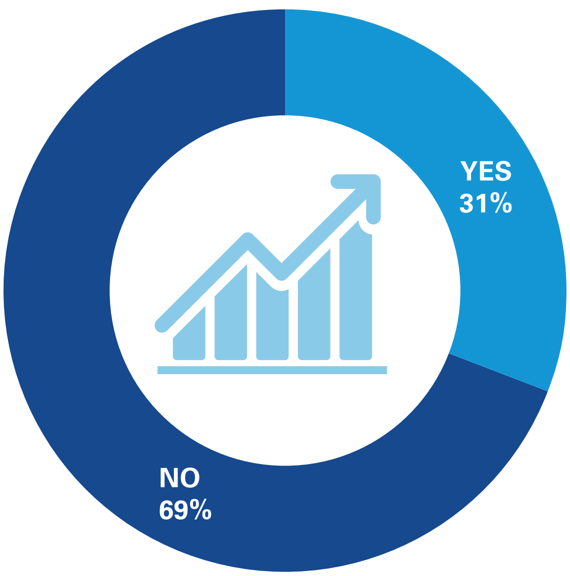
**"High valuations do not rule out a robust deal flow for financial or strategic buyers."**

**— Gavin Geminder, U.S. National Leader, Private Equity, KPMG LLP**

[3] *Source: FactSet November 2015*

### In your opinion, are the current market valuations sustainable for your industry?

(% of industry respondents)




The strong balance sheets tend to determine the method of financing deals. Forty percent say their preferred way to pay for M&A is with cash on the balance sheet, followed by a combination of cash and debt (25 percent) and a combination of cash and stock (14 percent).

"Market values will fluctuate depending on what acquirers are seeking" explains Alex Miller, U.S. Service Lead, Strategy, KPMG LLP. "Acquirers looking for access to innovation or new technologies will face the reality of higher valuations while acquirers looking to expand through new lines of business and wider geographic footprints will experience more modest market value changes."

Fear of losing ground to a competitor can also outweigh worries about lofty prices. "Even if prices are high, an investor may look to be aggressive on the buy side," says Alon Neches, head of Strategy Group and Mergers & Acquisitions/Global Strategic Planning at AIG. "If they don't own it, then someone else will, and that could have a deteriorative effect on the franchise."

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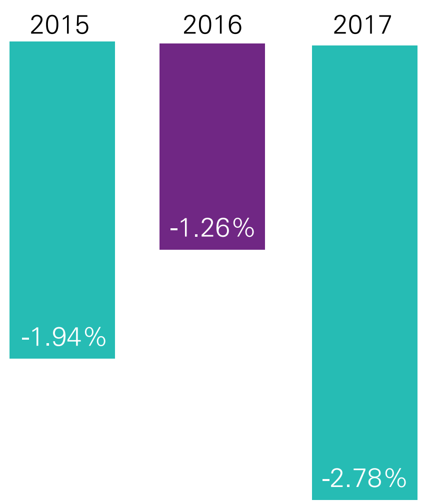
**— Alex Miller, U.S. Lead, Strategy, KPMG LLP**

# Drivers of deals

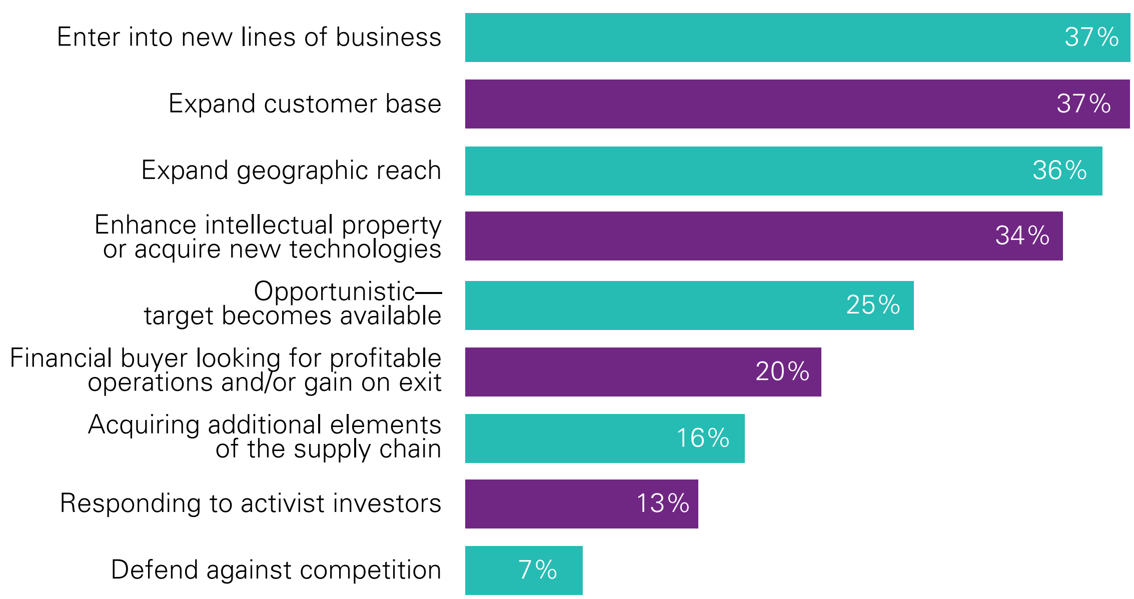
Bolstered by large cash holdings and the prospect of a faster momentum for dealmaking, companies surveyed are shifting their M&A strategies from consolidation in 2015 to expansion in 2016. M&A is an appealing strategic choice for companies in today's environment where S&P 500 Earnings Per Share projections have continued to decline, demonstrating weakening confidence in organic growth.

When respondents were asked to explain their strong appetite for M&A in 2015, the top factor by far was an organizational desire to fortify their competitive position. However, when asked the main reasons for acquisitions in 2016, respondents said they are primarily motivated by a desire to enter new lines of business, expand their customer base, and extend their geographic reach (between 36 and 37 percent each).

**S&P 500 Earnings Per Share projections[4]**




**What are the primary reasons for the acquisitions your company or fund intends to initiate in 2016?** (Respondents were asked to select up to three)




[4] *Source: CapIQ S&P Index December 2015*

Microchip Technology vice president and CFO Eric Bjornholt says his company "is not doing acquisitions to ward off competition," but deals that provide strategic growth do make his company more competitive in the marketplace. In 2014, Microchip acquired Taiwan-based ISSC for $329 million and Supertex, in Sunnyvale, Calif., for $394 million.

When asked which factors are most important when evaluating a target, not surprisingly the most important is strategic fit (67 percent). Other key factors include growth potential (56 percent) and the target's valuation and investment return (44 percent). The issue of cultural compatibility is least important (15 percent).

In the current environment high multiples can be an obvious deterrent to deal success. Tiemann recommends a deal strategy centered on identifying targets with good strategic and cultural fit. "Instead of starting with the price. First, is it strategic? Second, can I integrate it culturally? And third, does it make sense financially? People tend to focus more on the pricing instead of the strategic and cultural fit. In the end if the deal got the strategic and culture right, the price is most likely forgotten quickly."

KPMG's Miller agrees that cultural fit is key. He says, "Cultural fit may get fewer votes as a lens for evaluating acquisition targets. But cultural fit is pivotal in the long run to achieve the stated acquisition thesis. Merging cultures often determines strategic outcomes." Respondents seem to agree that corporate culture is still a key consideration. Fifty-four percent say cultural and HR issues are the most consistently challenging integration issues, far ahead of the integration of products and services (39 percent) and the transformation of sales and marketing (33 percent).

What factors might tend to inhibit M&A activity in 2016? Executives are most concerned with slowing economic growth (42 percent). Other important risks include rising interest rates (27 percent) and a lack of suitable targets (26 percent). Private equity firms are notably more concerned about interest rate increases (39 percent) than strategic buyers.

**"Instead of starting with the price. First, is it strategic? Second, can I integrate it culturally? And third, does it make sense financially?"**

**—Dan Tiemann, U.S. Group Leader, Deal Advisory and Strategy, KPMG LLP**

# Critical success factors

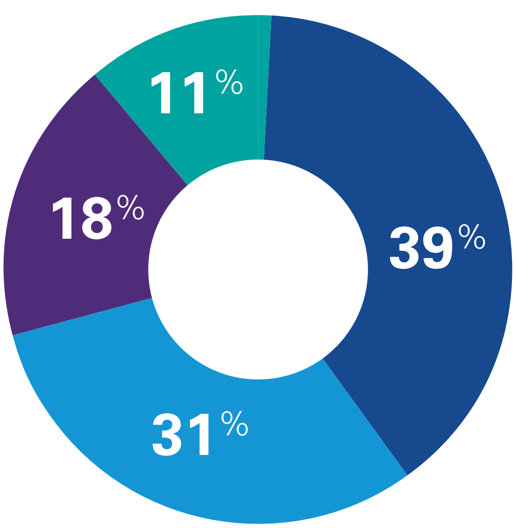
M&A is a notoriously difficult undertaking. According to survey respondents, the most important factor for the success of a deal is a well-executed integration plan (39 percent). Other key elements include the correct valuation (31 percent), an effective due diligence plan (18 percent), and the general economic environment (11 percent).

"Although due diligence may not be seen as the most important factor in deal success, it is obviously an essential part of deal execution. Without it, acquirers may be ill-prepared for what they have in store when they try to integrate their target. Effective due diligence helps to reveal risks and allows the acquirer to understand and tackle those issues pre-close," according to KPMG's Tiemann.

Early planning is key to developing a well-designed integration plan. In general, many of the important post-close issues will be revealed during due diligence. Companies tend to emphasize valuation issues during the due diligence phase.

### In your experience, what factor is most important for deal success?

(% of respondents)




However, by also focusing on integration risks and post-close opportunities, acquirers can gain important information that can greatly enhance deal results. During the first 100 days, management needs to develop a methodology for understanding exactly where and how the acquired company makes money. The management team must be able to track and prioritize the key profit drivers in the organization as soon as possible.

### Optimizing due diligence to achieve deal success

A retail company buying a specialty value add distributor was interested in understating if the acquired growth accurately reflected core growth of the Target. The acquirer needed real-time insights that were grounded in data analysis to ensure the deal's success.

As part of the due diligence process, KPMG quickly performed a detailed analysis of the target's data coupled with focused primary research to give industry context. Analysis included retail channel margin trends, customer segmentation, changing purchasing behavior between big box and independent retailers, and consumer behavior trends in key markets.

The acquisition thesis was built around the completion of multiple acquisitions to gain a national footprint resulting in projections of over 10% sales CAGR in an industry experiencing 5% annual growth and an EBITDA margin profile of 2x the industry average.

To achieve the stated goals the acquirer needed to understand the precision behind the forecasts. KPMG's optimized due diligence results gave the acquirer immediate insights into the following drivers:

- Identified critical gaps between forecasted growth and margin performance and most likely scenarios given recent market trends and data
- Challenged the viability of the Target's profile as a specialty value added distributor versus a wholesale distributor
- Identified opportunity to expand target market by 30% by further penetrating the market in states with 50% coverage

# Tax complexity generates opportunity

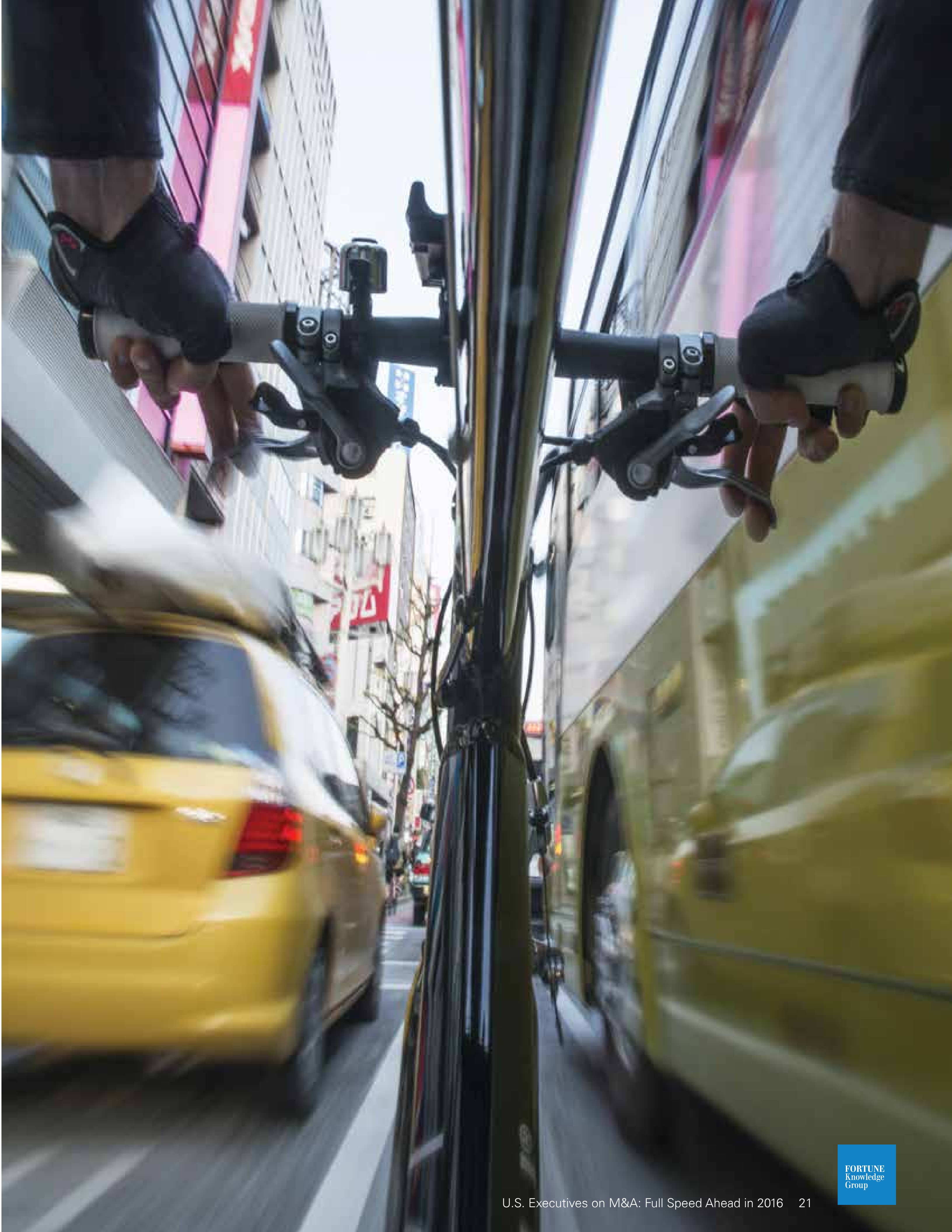
The survey responses reflect the tremendous significance of tax issues in M&A. Most respondents (67 percent) recognize the value of shaping their deals with tax implications considered from the outset (although a distinct minority, 26 percent, delays considering taxes until after the key deal terms and structure are decided). Tax-efficient structuring of M&A transactions can involve complex analysis, and nearly three-quarters of respondents expect growth in this complexity. While some of them view complexity negatively as a trap for the unwary, over half of them appreciate that complexity can generate planning opportunities.

Changes and opportunities in the international tax landscape have influenced executives and their companies to varying degrees. More than 40 percent of respondents report that their companies have considered using offshore cash to fund acquisitions. For life sciences companies, seeking lower tax locales drives a significant amount of M&A activity (27 percent of responses, the second highest after patent expirations). Meanwhile, nearly seven out of 10 respondents either believe that government proposals to address base erosion and profit shifting do not affect the financing or integration of their transactions, or lack awareness of the effect.

"Don't expect a reduction in the complexity of tax issues in M&A. M&A transactions can implicate intricate, ever-evolving tax regimes and structures. But these regimes and structures need not become a stumbling block if given thorough consideration during the planning stages of a deal. In fact, a tax adviser with a meaningful role early in the transaction life cycle can often uncover unexpected tax benefits," says Phil Cioffi, U.S. National Leader, M&A Tax, KPMG LLP.

**"Don't expect a reduction in the complexity of tax issues in M&A."**

**—Phil Cioffi,**
**U.S. National Leader, M&A Tax, KPMG LLP**





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# Conclusion

Looking ahead, we expect M&A to remain a critically important growth strategy in 2016. Executives surveyed say that their companies and funds will increase their deal volume and value.  However, in order to create the most successful deals, deal makers will need to stay focused on execution.

**View targets in real-world context and get the valuation right.** Record levels of cash, high stock prices, and receptive credit markets have made financing these deals relatively easy. However, as the survey demonstrates, easy money and optimism about the economy do not guarantee deal success. Companies need to focus on identifying the correct strategic partner and getting the valuation right. Global economic factors also need to be considered and the current international volatility is a factor that has geared U.S. acquirers to focus on U.S. deals.

**Optimized due diligence and early tax planning are key to execution.** The deep insights attained during due diligence not only identify potential issues–but also give a view into how the business can be integrated–before the deal closes. The ability to uncover and analyze deal data–in the compressed timeframe of the deal–is critical to understanding areas that require further analysis to make the best business decision.

**Well-executed integration plans are critical to realizing full deal value.** Integration plans developed in advance, along with effective due diligence can greatly increase the chances that deal meets its strategic objectives and improves shareholder returns. Both corporate and PE buyers can benefit from developing a 100-day plan in advance. Many of the most important post-close issues should be revealed and addressed during due diligence, including those surrounding human resources, information technology and tax.  During an exuberant deal cycle, focusing on these issues is a key step.

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# About KPMG's M&A Practice

At KPMG, we do more than just help you execute the transaction. We have structured our approach through and investor's lens to help you identify, evaluate, and successfully implement growth strategies and understand the true value of the business. Our proprietary tools and techniques such as Benchmarking Plus, Strategic Profitability Insights, and other data and analytics techniques can help you make informed decisions at deal speed and our experienced professionals will help you develop a roadmap to recognize the value.

KPMG's Deal Advisory 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.

Our Corporate Finance practice was recently named Investment Banking Firm of the Year by The M&A Advisor and provides a broad range of investment banking and advisory services to its domestic and international clients. Our professionals have the experience and depth of knowledge to advise clients on global mergers and acquisitions, sales and divestitures, buyouts, financings, debt restructurings, equity recapitalizations, infrastructure project finance, capital advisory, real estate, portfolio solutions, fairness opinions, and other advisory needs.

KPMG Strategy focuses on delivering corporate and private equity strategies based on our proprietary 9 Levers of Value framework, along with end-to-end implementation that helps companies get from strategy to results. Our dedicated M&A strategy professionals have deep strategic advisory experience, particularly in building equity value and accelerating growth.

KPMG's M&A Tax practice assists clients by creating tax efficiencies throughout the life cycle of a client's business. 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 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.

***We're KPMG Deal Advisory.***
***We think like an investor.***

# Methodology

KPMG, in partnership with FORTUNE Knowledge Group, fielded an online survey in October 2015 to measure the attitudes of U.S.-based executives toward the current market for M&A and its future prospects. All the companies surveyed are either planning a merger, acquisition, or divestiture in the next 12 months or have completed one in the past three years. The survey was answered by 553 people including chief executive officers, chief financial officers, and managing directors. They work for a range of organizations involved in M&A, including corporations, consulting firms and investment banks, and accounting firms and private equity firms. The market capitalization of 46 percent of the companies is $500 million and above. They invest in, and advise on, a wide range of industries, from consumer markets and financial services to pharmaceuticals and technology.

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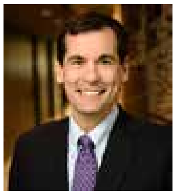

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