



From industrial to digital with M&A

How industrial players can maximize the success of complex technology acquisitions

Pressure to digitize product portfolios and internal capabilities in the industrial sector is increasing. Established players are aggressively competing over emerging technology acquisition targets, forming partnerships, and exploring creative deal structures with the promise of a more connected, intelligent, and autonomous industrial ecosystem. The keys to realizing the promise of these complex transactions is a careful balance between selective integration and holistic value capture along with a keen focus on talent and culture.

Introduction

Technological advancements are increasingly turning commoditized legacy industrial products and services into richer insight-driven offerings as part of an increasingly connected ecosystem. This trend has fueled a buying spree by manufacturers, construction firms, and industrial services providers to acquire technology companies (Exhibit 1).

These deals are critical to the future of manufacturing because companies cannot digitize by themselves. These transactions are also complex and challenging, requiring companies to integrate organizations with very different technologies, ways of working, culture, and talent.

As competition for tech acquisitions increases in industrial markets, high-quality targets are becoming scarcer. This scarcity has pushed up valuations through 2021, although valuations have cooled recently in 2022 and may

present buy-side advantages for opportunistic buyers during the current downturn.

According to industry research, software firms had an average deal multiple of 31x, while industrial products multiples hovered closer to the 10–15x mark.¹ For many industrial companies, the challenge in buying a tech business with a higher multiple is justifying to the market how the firm plans to capture synergies to unlock the value of the deal and increase shareholder returns.

Given these conditions, the stakes to successfully acquire, integrate, and derive sustained value from a technology company have never been greater. The combination of increased pressure on synergies and the fundamental business model differences between technology players and legacy industrial companies has significantly raised the stakes on integration complexity.

¹ Source: EBITDA Multiples by Industry, Equidam, Nov. 2021

A tech shopping spree by industrial companies

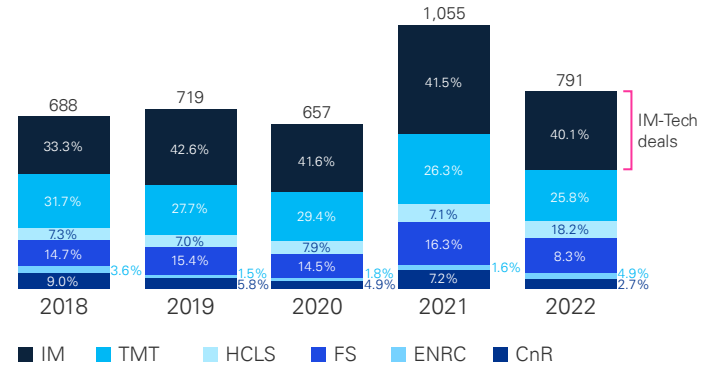


IM leads all non-tech companies in buying tech assets.

From 2018–2022, industrial market companies on aggregate acquired more technology companies than any other industry group. While deal volumes took a brief dip in aggregate during 2020, the share of technology companies purchased by industrials remained relatively steady from 2019 through 2022—signaling that technology acquisitions are more than just transitory.

The year 2022 provided a tale of two halves, as overall deal volumes cooled in the second half of the year. As it relates to non-tech companies buying tech businesses, deal volume remained fairly in line with the historical average over the last five years. Furthermore, industrials continued to buy the lion’s share of tech businesses.

Exhibit 1. IM leads all non-tech companies in buying tech assets (2018-2022)



Source: KPMG study, “Navigating complex M&A,” December 2022

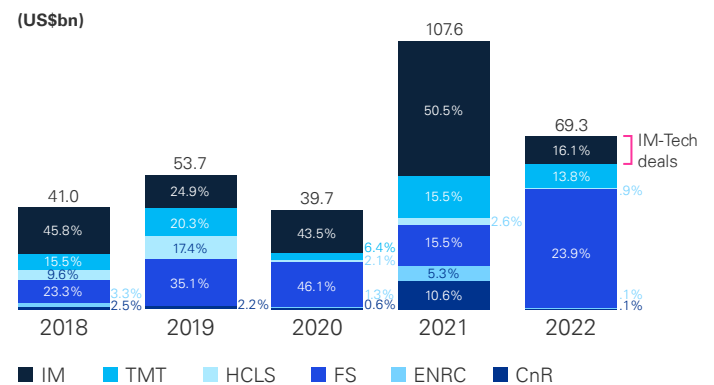


Industrials are consistently making bigger tech bets than most industry groups

In aggregate, industrial companies spent more on technology acquisitions from 2017 to 2021 than any other industry group—including within the TMT industry group itself. The 2021 spike in aggregate spending shows a three-fold increase from 2020 spending levels, which was largely driven by business services and construction and engineering sub-sectors. Some of the more established players leading the charge in 2021 tech-deal spend included Siemens, Honeywell, Hitachi, and Emerson. While the FS industry dominated acquisition spend in 2022, IM maintained its position as a top 3 spender.

The digitalization of all stages of industry—from design through manufacturing and sales—helps explain why IM has been consistently the largest acquirer of tech companies in recent years. Labor-intensive companies are seeking to automate as many tasks as possible using digital twins and robots to perform tasks once handled by increasingly hard-to-find workers.

Exhibit 2. IM has consistently been one of the biggest spenders on tech businesses (2018-2022)



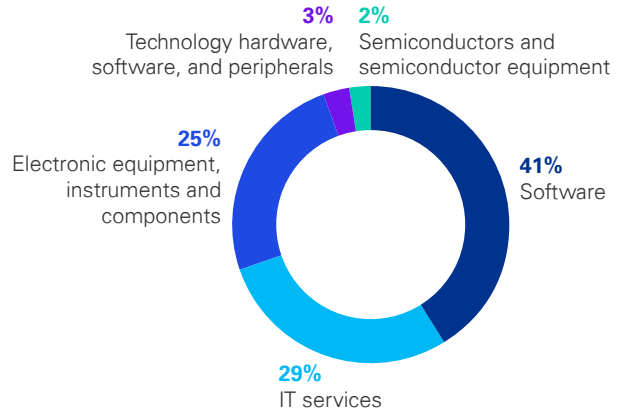
Source: KPMG study, “Navigating complex M&A,” December 2022



Software companies are the most frequent tech targets

Over the last five years, software companies made up the largest share of technology businesses acquired by industrial companies. Software companies are particularly attractive due to their high scalability and drastically lower marginal cost. While a software business can be acquired and operated as-is postclose, acquirers focused on maximizing long-term value should set their sights on developing their infrastructure to ensure connectivity between their legacy systems and the newly acquired business. This may entail investing in both middleware and sensor technology. For example, building management conglomerate Johnson Controls has a significant footprint of commercial HVAC, fire, and security equipment in buildings all around the world, equipped with sensors that feed data to their OpenBlue platform, which in turn can provide the customer with value-add services such as predictive monitoring and advanced analytics. JCI has already begun taking this approach, with the acquisition of their FogHorn software capabilities.²

Exhibit 3. Share of tech businesses acquired by U.S. industrial companies from 2017-2022



Source: KPMG study, "Navigating complex M&A," September 2022

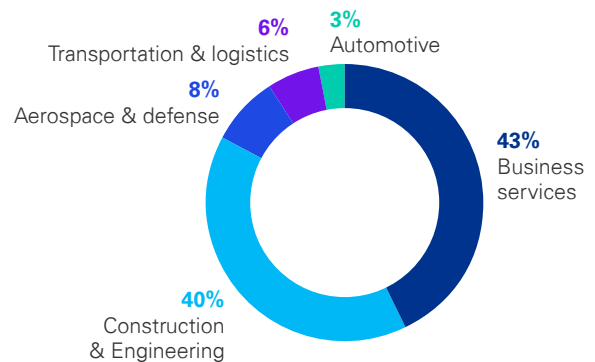


Business services and construction and engineering are buying the most tech

Within industrial markets, business services and construction and engineering have purchased the most technology companies from 2017-2022. According to KPMG research, business services buys the greatest number of software companies when compared to the other industrial subsectors, leveraging a distinct advantage to acquire and deploy SaaS acquisitions with relatively fewer barriers to integration than traditional brick-and-mortar subsectors.

Conversely, construction and engineering firms are acquiring more electronic equipment, instruments, and components. Engineering and construction firms are buying more hardware technology companies to allow their legacy machinery to be connected to the cloud and eventually provide value-added analytics to customers and internal users alike.

Exhibit 4. Share of tech company acquisitions by IM sub-sector (2017-2022)



Source: KPMG study, "Navigating complex M&A," September 2022

² Source: Johnson Controls First Quarter Fiscal 2022 Earnings Conference Presentation

A unique profile of risk and complexity

While tech deals may present a competitive advantage, they also present an outsized risk when compared to traditional in-industry deals. These risks largely revolve around lack of focused integration, underestimating commercial challenges, and heightened challenges with culture and customer change management.



Value erosion from lack of focus during integration

While any deal can suffer from a one-size-fits-all approach to integration, technology acquisitions tend to be at higher risk of being suffocated by traditional playbooks. A common mistake is relying on a traditional approach that too often forces uniform integration of people, processes, and systems by eliminating redundancies through a like-for-like exercise. Successful integrations enforce strict prioritization of workstreams based on expected value in lieu of a uniform approach. For example, commercial and product integration would take priority over back-office consolidation in a tech deal predicated on revenue synergies. While common sense, this often falls apart due to lack of focused governance and poor enforcement of trade-offs based on the expected value of integration projects.



Steep customer adoption curve

In cases where the technology acquired is customer-facing, existing customers may be skeptical about its potential reliability and added value. Successful integrators anticipate this resistance and proactively educate the customer by emphasizing the new offering's value rather than its features.

Subscription-based pricing models, common in software-as-a-service companies, present another customer adoption hurdle. Integration teams must develop pricing strategies that are representative of a cohesive offering, seamlessly blending the legacy industrial product and its newly added digital sibling.



Strong commercial network headwinds

Commercial integration plans and top-down synergies are at heightened risk of falling short in tech deals. As revenue synergies are becoming more important, deal teams are at risk of setting stretch targets without sufficient pressure testing from the regional, business unit, and commercial leads who inherit accountability. A proper bottom-up build can mitigate the risk of a failed transition of ownership from the deal team to the commercial team.

Customers are not the only ones who will need education on the newly acquired technology offering, as sales teams and downstream value chain partners, dealers, and distributors will also require training. Of course, synergies can be achieved by implementing technological solutions in some back-office functions such as finance, where artificial intelligence can increase efficiency in accounts receivable and accounts payable that can result in improved productivity and reduced headcount.



Unmanaged culture convergence

Tech companies are known for having inherently less bureaucracy, more innovation, and quicker decision-making instilled in their culture. Conversely, industrial companies positioned to pay the transaction multiple demanded by these companies are often larger, more structured, capital intensive, process oriented, and risk averse.

While this is evident in principle, many acquirers take culture for granted over the more mechanical aspects of integration. To promote continued innovation, savvy acquirers should invest in culture assessments to understand where to assimilate cultures or allow a period of incubation.



Heightened attrition risk and backfill scarcity

Titles and equity are two “me issues” that present a heightened risk of attrition with tech companies. These companies tend to be more generous with lofty titles than their larger industrial counterparts. Furthermore, equity awards tend to go to deeper levels of a tech company than at a legacy industrial company. Matching compensation becomes a delicate exercise in part due to the fact that tech employees may see their current shares as more valuable independently. These two aspects are key make-or-break factors for retention.

When considering areas of greatest flight risk, engineers and salespeople top the charts. While the postpandemic job market suggests all talent is scarce, these two categories present an outsized risk.



How industrial players get tech deals right

Industrial acquirers seeking to gain an edge in preserving the value of tech-advanced targets consistently follow a select few key principles. These largely revolve around exploring synergies beyond the traditional cost side, carefully integrating operations, and empowering the target to have a path in the new organization.

01 Integrate selectively to minimize disruption and preserve value

What sets apart successful tech-business acquirers is their focused approach to integration. Acquirers often struggle to strike a balance between two extremes. Successful tech acquirers work backwards from the end state to pinpoint with precision which areas need to be integrated and to what degree. Case in point, KPMG worked with leading agriculture and construction company CNH Industrial to align on a prioritization structure that focused on unlocking the value of their Raven Industries acquisition by relentlessly dialing up integration efforts on

short-term cross-selling and bringing an autonomous product to market. Value-driving workstreams were prioritized to allow Product Technology and Commercial teams to obtain the required support and resources and were in turn supported by value-preservation workstreams such as Human Resources, Information Technology, and Finance. Fast forward approximately one year, and CNH Industrial and Raven Industries have successfully unveiled an integrated product, the first autonomous spreader in the industry.

02 Pursue alternative deal structures and partnerships to minimize risk

Alternative deal structures such as joint ventures (JVs) are critical to leading acquirers' playbooks. Two common types of JV structures, equity and contractual, can be beneficial depending on the conditions. In an equity JV, the two partners contribute resources to create a new company, while in a contractual JV both partners can collaborate through a contractual alliance without forming a new company.

The recent semiconductor shortage has served as a catalyst for such alliances in automotive especially. For example, Sony and Honda announced a JV to compete in electric vehicles (EVs), and Stellantis and Samsung SDI invested more than \$2.5 billion to

rapidly produce lithium-ion EV batteries. In another case, in 2019 Toyota announced a JV with its parts maker DENSO to develop semiconductors for EVs and autonomous vehicles.³

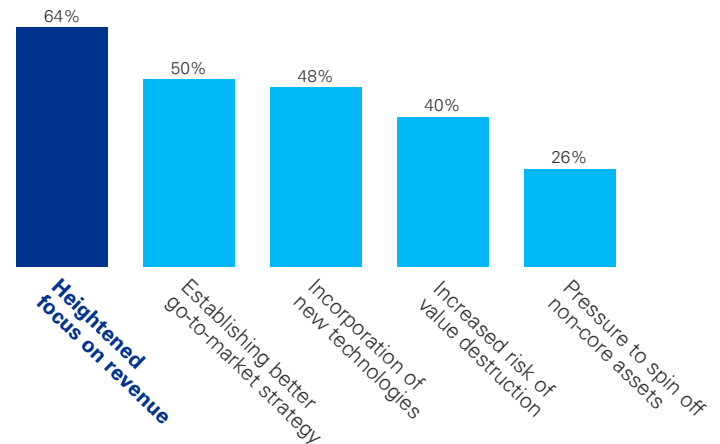
Smart acquirers also look to existing vendors or partners for potential acquisition targets. Existing vendor relationships inherently provide an opportunity to test the waters with your customer base and explore potential applications for a more seamlessly integrated product offering at arm's length. Leveraging existing partnerships can accelerate integration planning and increase the chances of bringing a successful combined offering to market postclose.

³ Source: The most significant and innovative automotive joint-ventures of 2022 so far, cbtnews.com, Aug. 9, 2022

03 Lean in on revenue synergies to stretch beyond targets

The case for revenue synergies is most evident with software acquisitions geared towards enhancing the end-customer value proposition. In these businesses, the marginal cost of incremental sales is often more favorable than the conventional industrial product or service. Due to favorable scalability, integrators should prioritize efforts to weave the software service as a value-add to its existing installed base. In a recent KPMG study, industrial executives ranked a heightened focus on synergies as the number one factor making unlocking deal value more complex. When geared towards enhancing the product portfolio, value capture from technology acquisitions is not as simple as cross-selling. It often requires first integrating the product technology in order to provide a cohesive product to the customer rather than disparate add-ons.

Exhibit 5. Within industrial markets, how has unlocking value become more complex with deals?



Source: KPMG study, "Navigating complex M&A," September 2022

04 Make engineers, salespeople, and culture leaders a priority

Three categories of talent tend to be especially problematic flight risks when acquiring a technology company. The first is engineers—namely those with expertise in AI, automation, analytics, cloud computing, and machine learning. Common issues with this category are deeper equity compensation, seniority of title, and flexibility. The second is salespeople—those who have been trained in the technical aspects of the target's product. Much like engineers, replacing these key individuals would affect the growth prospects of the target business and

require significant investment to retrain. Common issues with this category are changes often required to obtain revenue synergies, including realignment of customers, cross-training, and adjusting sales goals tied to compensation. Lastly, culture leaders are individuals who may sit anywhere in the organization and are respected as linchpins. These individuals are often best identified by senior management and should be positioned as leaders in the integration effort to promote engagement.



05 Expand diligence focus to commercial, software, and product integration

Maximizing the value of a technology acquisition requires looking beyond traditional back-office due diligence focus areas, using the diligence phase to identify and validate value creation. During this phase, acquirers should place a heightened focus on commercial and product integration planning.

Commercial diligence provides an unbiased assessment of factors impacting the commercial viability and opportunity of the target business by evaluating dimensions including market, competition, business plan, customers, and commercial operations. Acquirers leverage this critical diligence exercise to gain a greater sense of return on investment, external effects of

the business, influence of competitor's business, and the tools to have a more informed negotiation.

Product integration planning aims to evaluate the target's product vision, strategy, roadmap, organization, intellectual property, and key processes. While there may be constraints to sharing the underlying detailed data until the deal is closed, the effort can assist in identifying technical red flags that may be major hurdles to integrating the target's product or service post-close.



Spotlight client success story

Autonomy transformation through M&A

Leading ~\$33 billion agricultural and construction machinery player CNH Industrial added strong innovation capabilities in autonomous and precision agriculture technology through its acquisition of Raven Industries. Within 12 months of acquiring Raven Industries and its autonomy technology, CNH Industrial brand Case IH introduced the agriculture industry's first autonomous spreader, the Case IH Trident™ 5550 applicator with Raven Autonomy™.

KPMG assisted CNH Industrial in its transformational \$2.1 billion acquisition and integration of Raven Industries, simultaneously supporting the successful carve-out and divestiture of two non-core business units, Engineered Films and Aerostar.

Critical success factors:

- ✓ Tailored integration program focused on driving value from Commercial and Product Technology, with the back office and operations supporting the value driver objectives
- ✓ Early focus on product technology fit in the diligence stages
- ✓ Fit-for-purpose synergy realization approach prioritizing revenue synergies
- ✓ Intentional retention approach and preclose culture assessment to minimize attrition



Note: CNH Industrial reported approximately \$33b in 2021 net revenues prior to the demerger of its on-highway business.

How KPMG can help

From early-stage deal strategy to integration and value capture and every step in between, KPMG assists industrial companies with successfully integrating complex technology businesses and driving long-term value.

01 — **Integration strategy and diligence**

We assist industrial companies in formulating integration strategies and differentiated diligence tailored to the deal to provide an early-stage point of view on the path to unlocking the deal's promise.

02 — **Value-driven integration planning and execution**

We assist clients with designing and operating integration programs that focus on unlocking the deal's value promise using a fit-for-purpose approach tailored to the deal rationale.

03 — **Product technology integration and back-office IT**

We assist clients from diligence through post-close integration as it relates to both product technology and back-office IT, keeping a careful eye to technology fit and integration potential, as well as potential cost implications.

04 — **Culture assessment and harmonization**

We assist clients with defining and assessing the more elusive attributes of both their cultures and the culture of the acquisition target, providing insights to inform integration decisions and further cultural assimilation of the two organizations.

05 — **Carve-out divestiture of noncore business units**

Desirable tech acquisition targets may come with other noncore assets "bundled" into the deal. During integration planning, we assist clients with planning for the carve-out and eventual divestiture of these assets to recover cash that can be investment in the core business's growth.

06 — **Employee experience and talent retention**

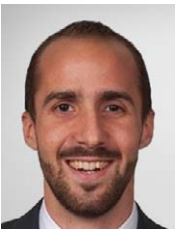
We assist with identifying and building programs that engage the acquired employees, help them see the potential in the transaction, and create financial and non-financial retention programs that preserve deal value.

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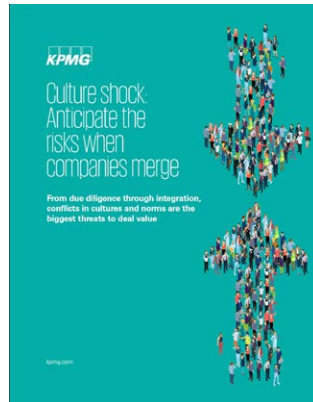
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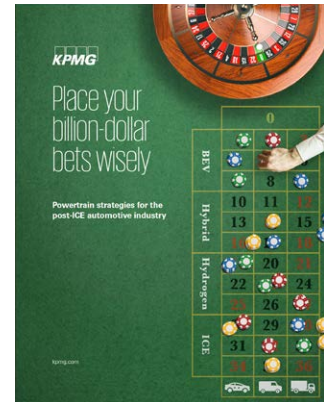
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