2013 M&A Outlook Survey

Executives Expect M&A Market to be Active in the Year Ahead

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The last year has been a tumultuous one for the capital markets. The global markets were overwhelmed with the European debt crisis and a slowdown of growth in emerging markets, including China. The U.S. experienced large stock market swings, the uncertainty of the Presidential election, and the looming fiscal cliff. In 2012, U.S. deal value decreased four percent from 2011. However, several factors indicate that M&A will increase in the year ahead. Companies continue to hold record levels of cash on hand, interest rates are at historic lows, debt on favorable terms is readily available, and the U.S. stock market has rebounded. In order to gain a better understanding of the current M&A market, KPMG engaged the Research practice unit of SourceMedia, the publisher of *Mergers & Acquisitions*, to conduct a survey of more than 300 M&A professionals at U.S. corporations, private equity (PE) firms, and investment funds immediately after the U.S. Presidential election.

Despite many uncertainties, the current economic environment appears relatively resilient. Consumer confidence increased to 73.7 percent in November, its highest level in four and a half years¹ and the S&P 500 ended the year up over 13 percent.

How did respondents feel about the general state of the economy? A little over one third (37 percent) said that they expected U.S. GDP to increase this year, 39 percent expected it to increase next year, and 24 percent said a more robust recovery would not take place until 2015 or beyond.

¹ The Conference Board, November 27, 2012.
Deal Activity Expected to be Strong

In general, survey participants felt relatively positive about the deal environment. About one-third (35 percent) said that they were more optimistic about the M&A market today than one year ago, and 44 percent of respondents said that they currently felt “about the same” as they did one year ago. Only three percent of respondents were significantly less optimistic.

The factors that are expected to most facilitate deal activity include the existence of large cash reserves (60 percent), favorable credit terms (40 percent), opportunities in emerging markets (26 percent), and improved consumer confidence (18 percent).²

**Factors Facilitating Deal Activity**

- Large cash reserves/commitments
- Availability of credit on favorable terms
- Opportunities in emerging markets
- Improved consumer confidence
- Resolution of European economic crisis
- Improving equity markets
- Improved employment numbers
- Recovery of financial services sector
- Other

With the vast majority of respondents expecting economic growth to take place in the next two years, it is not surprising that they expect their own companies to be active acquirers. Seventy-six percent of respondents said they expected their companies to make at least one acquisition in 2013. The largest percentage (26 percent) said they would be making two deals this year; 10 percent said they would be making three acquisitions and eight percent said they would be making four acquisitions in 2013.

“Although there is still plenty of uncertainty in the markets, we will likely see M&A activity pick up as the year progresses,” according to Dan Tiemann, Americas Transactions & Restructuring lead for KPMG. “Financing conditions continue to be positive. Many companies are holding large amounts of cash and the U.S. debt markets remain open.” It is also likely that PE buyers will increase their deal activity in the next 12 to 18 months, according to Marc Moyers, KPMG national sector leader for Private Equity. He said, “PE funds also have large amounts of uninvested capital and are looking for good deals. PE investors will continue to seek out U.S. companies with significant upside potential, as well as emerging markets with strong growth opportunities.”

² Multiple responses permitted.
Growth Opportunities Motivate Deals

Which factors will be motivating these deal-makers? Respondents said that the number one reason for making an acquisition was to expand their company’s geographic reach (20 percent). Other important reasons included PE buyers seeking profitable operations (19 percent), entering into a new line of business (17 percent), and expanding their customer base (15 percent). Several respondents also noted that sellers seem more realistic about valuations and deal prices had gotten more attractive. One respondent said he thought his company would do more deals in 2013 because of “more reasonable seller expectations” and another noted “very low prices.”

**Primary Deal Motivators**

- Expand geographic reach
- Financial buyer looking for profitable operations and/or gain on exit
- Enter into new lines of business
- Expand customer base
- Introduce new products
- Deploy capital
- Enhance intellectual property
- Other
- Bring in-house another function in the supply chain

Last year saw several blockbuster deals, including Softbank’s $20.1 billion bid for a stake in Sprint Nextel and Nestle’s $11.9 billion deal for Pfizer’s infant nutrition unit. However, the middle-market remained the most active sector. Respondents confirmed that deal size is expected to remain on the smaller size. Seventy-nine percent of respondents said that they expected their deals to be valued at $250 million or less. (By comparison, in last year’s survey, 68 percent of respondents said their deals would come in 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 less than two percent said their companies would be doing deals valued between $1 billion and $5 billion. KPMG’s Phil Isom, principal and U.S. leader for its Corporate Finance and Restructuring practice said the survey results are consistent with what he is seeing in the marketplace. “Middle-market deals continue to be the most active. Given the smaller valuation ranges, and shareholder base (frequently owned and operated by entrepreneurs or management team), they are easier to finance and get across the finish line despite a still somewhat uncertain economy,” he said. “In addition, many restructuring opportunities still exist in this segment.”

**Deal Size Stays Small**

- Less than $250 million
- $250 million to $499 million
- $500 million to $999 million
- $1 billion to $5 billion
- Greater than $5 billion
In terms of which industries would be most active in 2013 and beyond, respondents expected software/telecommunications/technology to be the most active sector (39 percent), followed by healthcare/pharmaceuticals (35 percent), energy (31 percent), and financial services (20 percent). KPMG’s Moyers agreed that technology and healthcare will continue to be attractive, especially for PE investors. “The constantly evolving world of technology, and investment opportunities that arise as we get more clarity around Obamacare, will create attractive opportunities in those sectors,” he said.

### Industries with the Most Activity

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Software/telecommunications/technology</td>
<td>39%</td>
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<tr>
<td>Healthcare/pharmaceuticals</td>
<td>35%</td>
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<tr>
<td>Energy</td>
<td>31%</td>
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<tr>
<td>Financial services</td>
<td>26%</td>
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<tr>
<td>Industrial products</td>
<td>24%</td>
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<tr>
<td>Consumer products/food and beverage</td>
<td>24%</td>
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<tr>
<td>Electronics</td>
<td>22%</td>
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<tr>
<td>Professional services (e.g., law firms, accounting firms, etc.)</td>
<td>21%</td>
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<tr>
<td>Automotive</td>
<td>18%</td>
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<tr>
<td>Transportation</td>
<td>17%</td>
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<tr>
<td>Chemicals</td>
<td>15%</td>
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<tr>
<td>Retail</td>
<td>12%</td>
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<tr>
<td>Other</td>
<td>9%</td>
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<tr>
<td>Media</td>
<td>4%</td>
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<tr>
<td>Government/higher education/not-for-profit</td>
<td>2%</td>
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</tbody>
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**Note:** Multiple responses permitted.

The vast majority of respondents (73 percent) expect North America to be the most popular deal destination. Other regions where M&A is expected to be robust are Western Europe (28 percent), China (27 percent), Brazil (20 percent), and Asia, excluding China and India (19 percent). Tiemann explained, “North America’s relative fiscal health and recovering consumer markets make it a popular investment destination. The European debt crisis will also create investment opportunities, especially in the distressed sector. And the growth prospects of the emerging markets make them almost necessary deal locations for firms seeking revenue growth.”

### Most Popular Regions

- North America: 80%
- Western Europe: 40%
- China: 27%
- Brazil: 20%
- Asia (not including China or India): 19%
- South America (not including Brazil): 18%
- Eastern Europe (not including Russia): 15%
- India: 10%
- Middle East/Africa: 9%
- Russia: 8%

**Note:** Multiple responses permitted.
Although deal-makers were generally optimistic about activity levels, they did cite several concerns and noted that due diligence remained even more important in today’s volatile environment. Almost two-thirds (62 percent) of survey respondents noted that they thought deal activity would be most inhibited by recessionary fears and a slow growth environment. Other issues they thought would slow deal flow included uncertainty surrounding tax code changes (31 percent), concerns about Europe (23 percent), and regulatory considerations (21 percent).\(^5\)

In terms of due diligence, respondents said their greater challenges were presented by the assessment or volatility for future revenue streams (43 percent). Other important challenges included assessing the target’s quality of earnings (31 percent), revenue and cost synergy analysis (25 percent), and issues surrounding the cultural assessment of the target (21 percent).\(^6\)

“It is also crucial to analyze tax issues and implications as part of the due diligence process,” according to Lisa Madden, KPMG’s leader of M&A Tax. “Over the last several years, there has been a large degree of uncertainty concerning tax issues and buyers need to have a thorough understanding of how different tax outcomes might affect their deals and deal structures,” she said. The vast majority of respondents agree: they do consider tax implications at the outset of a deal (69 percent). Another 28 percent said that tax issues are considered after key deal terms and structures are finalized.

Similarly, integration issues also present significant challenges and should be analyzed during the due diligence stage of a deal. The most significant integration issues for respondents were cultural issues (38 percent), closely followed by human capital issues (36 percent), operational and rationalization issues (34 percent), and issues arising from integrating products and services and accounting systems (both 17 percent).\(^7\)

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\(^5\) Multiple responses permitted.

\(^6\) Multiple responses permitted.

\(^7\) Multiple responses permitted.
Corporate Buyers have a Slight Edge

When asked which exit strategy would be preferred by sellers in 2013, 65 percent of respondents said they thought companies would prefer to sell to a strategic buyer. Eighteen percent said they thought sellers would prefer to sell to a financial buyer, 13 percent said they thought companies would choose to refinance or raise debt capital, and three percent said that companies would prefer an IPO.

It is always interesting to try to determine who will have an edge when seeking out the most valuable targets. In light of the responses given to preferred exit strategies, it is not surprising that according to 44 percent of respondents, corporate buyers have a slight advantage in the current deal environment. Thirty percent said they thought PE buyers would have the advantage and 17 percent said neither would have an advantage. Corporate buyers would most likely have an advantage because they would have greater synergy opportunities and thus be able to pay a higher price in an auction situation.

Conclusion

The last few years have provided the M&A market and the economy in general with many challenges. More certainty around U.S. fiscal and tax policy and movement on the European debt crisis should further solidify consumer confidence and improve global economic prospects. Despite the fact that uncertainty still exists, dealmakers are cautiously optimistic and the vast majority of them said they will be seeking growth opportunities through acquisitions this year. An improving M&A market should begin to take shape in 2013 and extend into the near future.

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8 The remainder of respondents had no opinion.
For more information, please contact

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