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M&A Spotlight on:

The 2017 deal environment

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Expect 2017 deals to be motivated by limited organic growth and business transformations

Despite global economic uncertainty—including the Brexit vote and slowing growth rates in the emerging markets, a U.S. presidential election, and mixed signals from the Fed—deal activity remained steady last year. There were $3.7 trillion in announced deals in 2016, the third most active year on record, according to Dealogic. Megadeals in several industries were announced, including the $84.4 billion merger of Time Warner and AT&T, Bayer's $66 billion acquisition of Monsanto, and Qualcomm's $47 billion purchase of NXP Semiconductors.

This year is also expected to be a healthy one for private equity (PE) and corporate deal-makers, according to KPMG LLP's (KPMG) recent M&A Market Pulse survey of almost 100 deal professionals. Last year, 83 percent of those surveyed completed at least one deal. Of that same group, 84 percent expect to complete at least one deal this year, 21 percent expect to complete two deals, and 25 percent expect to complete three to four deals.

The deal environment remains positive

The deal environment has several things going for it. Corporations continue to have record amounts of cash on their balance sheets and interest rates remain relatively low. M&A continues to offer companies the fastest route to enter new markets and acquire needed technology. According to respondents, their companies' acquisitions will be primarily motivated by limited organic growth options (40 percent), the need to address transformation in the marketplace or in existing business models (25 percent), and the availability of credit on favorable terms (17 percent).

When pursuing acquisitions, deal-makers had several strategic goals in mind. They were most focused on acquiring relevant technologies (27 percent), responding to transformation in the marketplace (22 percent), and expanding their product reach (22 percent). These survey results have been reinforced by KPMG's research and client conversations. "All industries are being challenged with technological innovations that are requiring them to rethink existing business models and explore how they can get ahead with their own transformative technologies," according to KPMG's Dan Tiemann. Acquiring the right innovations has become imperative for today's business community.

Not all deals are created equal

Megadeals may grab the headlines, but consistent with last year's survey, middle-market deals are expected to dominate. Forty-seven percent of respondents said their deals would be worth $250 million or less and 31 percent expect this year's deals to be worth between $250 million and $500 million. "The middle-market should continue to be quite active. These deals are relatively easy to finance and help companies purchase missing technologies or other assets that fit their strategic needs," according to KPMG's Phil Isom. "These smaller deals are also less difficult to integrate, and results can be realized much more quickly," he adds.

Which industries are expected to be most active for deals in 2017? According to respondents, technology will be most active this year (45 percent), followed by energy (31 percent), oil and gas (28 percent), and pharmaceuticals and biotechnology (22 percent).[1] Technology acquisitions are becoming more and more important for all industries. Tiemann explains, "We anticipate smaller, technology acquisitions to wrap around all industries. Technology is key to driving growth for all organizations in today's disruptive environment. Tech is needed to expand capabilities, products, and services."

[1] Multiple responses permitted.

Much of the world is facing global economic and geopolitical uncertainty, in addition to slower growth. Although there are certainly many unknowns, investors in the U.S. face a relatively stable economy and none of the risks that pop up in cross-border deals. It is not surprising that this year the U.S. is again the preferred investment destination (79 percent), followed by Western Europe (38 percent) and China (17 percent).[2] Although investing in China remains complex, that country still offers some of the world's larger growth prospects.

Challenges exist

Despite feeling generally upbeat about the deal environment, respondents noted that challenges always exist. For companies and PE funds that started an acquisition but did not complete the deal, the primary reason was valuation issues (36 percent). Last year's deals were also not finalized because a potential acquirer lost a bidding war (22 percent) or because of problems that were revealed during due diligence (11 percent). Recent regulatory issues did not deter deal-makers (4 percent). Tiemann notes, "We continue to see a gap between buyers and sellers as they pursue the transaction process—but, most buyers will pay a premium for the right target that meets their organization's strategic needs."

Going forward, respondents cited several possible factors that might inhibit deal activity this year. Deal-makers were most concerned with a slowing economic environment (32 percent), a lack of suitable targets (28 percent), and record stock prices (12 percent).

Conclusion

Several structural factors continue to indicate that deal activity will be steady this year. Cash is abundant, stock prices are high, and interest rates are still relatively low—creating robust financing options. Perhaps more importantly, companies across all industries will be looking for assets that help them deal with today's quickly evolving business models and innovations. As always, acquirers need to make sure any potential target meets their long-term strategic needs and that the due diligence process is thorough and includes an analysis of all potential risks, in addition to financial issues.

[2] Multiple responses permitted.

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