KPMG Webcast: Anticipating the M&A thaw

The stagnant state of the deal market and what strategies will benefit from its revival were the focus of a recent KPMG webcast entitled, "Anticipating the M&A thaw." Taking part in the discussion were a panel of KPMG deal professionals, including Dean Bell, Market Activation Leader for the KPMG Deal Advisory and Strategy business, Cathy Bedrick, U.S. Financial Due Diligence Leader, Phil Isom, Global Head of M&A, and Scott Rankin, Global and U.S. Strategy Leader.

The mergers and acquisitions market is currently troubled by many uncertainties, prompting deal practitioners to reconsider their best course of action in the current complicated conditions. Nonetheless, KPMG increasingly sees interest from a wide range of clients to move forward with transactions, whether on the deal side or with alternative activities such as performance improvement.

As people get ready for a recovery in the M&A market, KPMG is working with its clients to create a game plan for when the market begins to revive. Bell recalled that M&A also had frozen as recently as 2020, but once the ice jam began to melt there was a frenzy of M&A activity. "Make no mistake, deals will come back at a more regular pace," he said. "The question is, will you be positioned properly in time for the anticipated thaw? Are you trying to survive or thrive?"

Bell told the webcast that KPMG is seeing companies navigate the current period in different ways. He noted that based on the data emerging from research on the KPMG global platform, three archetypes have emerged that show the differences in how companies are adapting to the current environment:

1. One group of companies is focused on performance and waiting until the storm passes, while digesting what is currently going on and getting themselves ready for the next phase.

2. On the polar opposite is a group of more aggressive players in the market, taking advantage of this pause by proactively seeking opportunities to transform or optimize their businesses and continuing to do M&A deals by taking advantage of competitive pricing.

3. Another group of companies are in the middle, staying active by making smaller acquisitions, divesting, or getting themselves ready in other ways for the time when the deal freeze starts to melt. One firm, Penske Truck Leasing, told the webcast for example that it is maintaining regular contact with a number of business leaders in hopes of doing deals when market conditions are more conducive. (Exhibit 1)

Exhibit 1: Penske Truck Leasing

As part of the KPMG webcast, Scott Cebul, senior vice president and treasurer of Penske Truck Leasing, provided his insights on how his company is using M&A to achieve its strategic goals in the current market.

According to Cebul, Penske achieves growth through three channels: adding new business from existing customers, adding customers to the company's existing customer base, and through acquisitions. "We continue to look for the right opportunities," he said, adding "it's important for growth that we do it not only through organic channels, but also do it through targeted acquisition." He added that there is a "strong focus all the way up through the CEO's office on acquisition as a growth channel, which is strategic to how we grow our business."

Penske looks at return on equity, return on investment, and synergies as key metrics when doing deals. "The challenge is we're in a market where rates have changed significantly, with the increase in variable rate debt of 500 basis points in a short period of time," he said. "That obviously changed some of the metrics and led to further discussions around some of the acquisitions, but that doesn't change cultural fit. Even though we saw some challenges, with increasing rates and different business dynamics, we were still able to get transactions closed."

While M&A volume is currently depressed, Cathy Bedrick highlighted that many corporate clients have stayed committed to their original investment thesis. Despite the uncertainty in the financing markets and differences in bid/ask spreads, they are finding ways to get deals done. "Even in this more challenging market, a lot of them are looking at how to do acquisitions to help [spur growth], whether it's product line expansion or geographic expansion," Bedrick said.

Asked about private equity deals, Bedrick indicated that many of the large deals getting done at the moment are take-private deals. These deals have been more prevalent as sellers are looking to leave the unpredictability of the equity markets and PE firms have less concerns about bid/ask spreads as the public markets reprice assets more quickly than private markets. On the other end of the spectrum, she said PE firms are also focusing on add-on transactions, which accounted for over 80 percent of PE deals in Q1'23 as these deals can often be financed off the portfolio companies balance sheets.

Scott Rankin said that unlike in periods of growth, in a downturn, companies need to have extreme discipline about their core business and focus on areas where they can drive differentiation and advantage. "We're seeing both deal activity from the buy side for companies that want to invest in their core and build bigger moats around their business, but we're also seeing a lot of divestitures and sell side activity," Rankin said. "It's buying things that are core to the business, and selling things that are not core to the business."

In response to concerns about liquidity issues facing companies, Phil Isom said, "it's a really massive shift, with interest rates up 500 basis points from a period of extremely low rates. I think that the market is starting to find its footing and we're getting closer to the top, which does help everyone reset where their expectations are going to be." He added that the lender universe is also shifting, with alternative lenders such as hedge funds entering the market for middle-market finance.

Bell asked if interest rates were the main reason the M&A market was treading water. Bedrick replied that while interest rates were a major factor, it was less the rate itself than the uncertainty about future rates. "People are still going to do deals at 5 and 6 percent rates, but they're not going to do deals when they don't know where it's going to go," she said. "Because of antitrust rules, do you want to enter a deal now when you don't know what the interest rate is going to be when you have to close?" She added that as deals get more expensive because of the rates, companies are having to perform more due diligence work.

Rankin said that "there is significantly more rigor now" in conducting diligence, with more comprehensive operational and deeper financial due diligence. "In commercial, for example, people are taking a look at contracts, pricing, and rebate structures to figure out how to pull different levers to make money more easily," he said. There is also more focus on improving working capital with cash becoming king, requiring inventory productivity and optimization, and stretching vendors to longer payment periods.

The webcast then turned to the question of what corporates should do now. Isom said companies are starting to look at their core operations and where they want to invest versus just looking at pure growth, going beyond margin cost to things like people issues.

Rankin added that many companies have now shifted focus to maximizing the value of the businesses they already have and achieving synergies that were the original rationale for the deal but never fully implemented. For example, he said platform companies that may have combined 15 different businesses during a growth phase might have 15 different HR and finance functions. "There is a lot of redundancy in platforms if you don't integrate the business," he said.

He also noted that companies are focused on taking costs out of their organizations in three ways. "They rip out general and administrative expense and direct marketing spend," he said. "Then they can focus on improving margins. So they go after their suppliers to improve cost of goods sold ratios to drive margins up, or they can focus on things like supply chain efficiency. The third thing is to focus on working capital with things like inventory productivity and making sure that accounts receivable and accounts payable are in good shape."

Bell asked the panel where KPMG sees its clients taking advantage of current valuations and engaging in transactions.

"We're actually helping a couple of large corporates right now with divestitures, so carving out the operations that they deem to be non-core," Isom said. Because corporates are less interest rate-sensitive, they are focused on reprioritizing cash and moving it from one asset to another.

"There are certain assets that have multiples that are still holding very strong," he noted "And then there are certain companies that might have to spend a little more time on operations and diligence to prove things out so that they can get the maximum value for their asset."

Bedrick said that KPMG is seeing activity in sell-side prep as clients don't want to get left unprepared when the market comes back. She noted that around 40 percent of deals KPMG is working on are sell-side transactions, noting that over the past seven to eight weeks there has been an uptick in work on those deals.

One bright spot is in the infrastructure sector, where a number of recent government programs, such as the Infrastructure Investment and Jobs Act, have provided an infusion of capital for major projects. "We're seeing massive demand—companies are investing, whether it be utilities or renewables or looking at energy transition." Isom noted that firms are taking advantage of tax incentives, tax credits, and a variety of government stimulus programs to generate new business.

The panel agreed that the upsurge in M&A related to infrastructure is a bellwether of a likely return to a more normal transaction market, although the exact timing of the thaw is still unclear. Rather than waiting for the market to turn before acting, the panel concluded that companies should use this time to get their companies in the best possible shape for the next chapter of dealmaking.

A key to preparation is by implementing a program of transformation to take costs out of existing business, reinforcing strategic imperatives and ensuring that people and capabilities are aligned. The next KPMG webcast in July will be focused on how companies can successfully prepare and achieve transformative transactions.

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