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Charting New Horizons
Path to Thrive

21 November 2023

Introducing Charting New Horizons: The Path to Thrive

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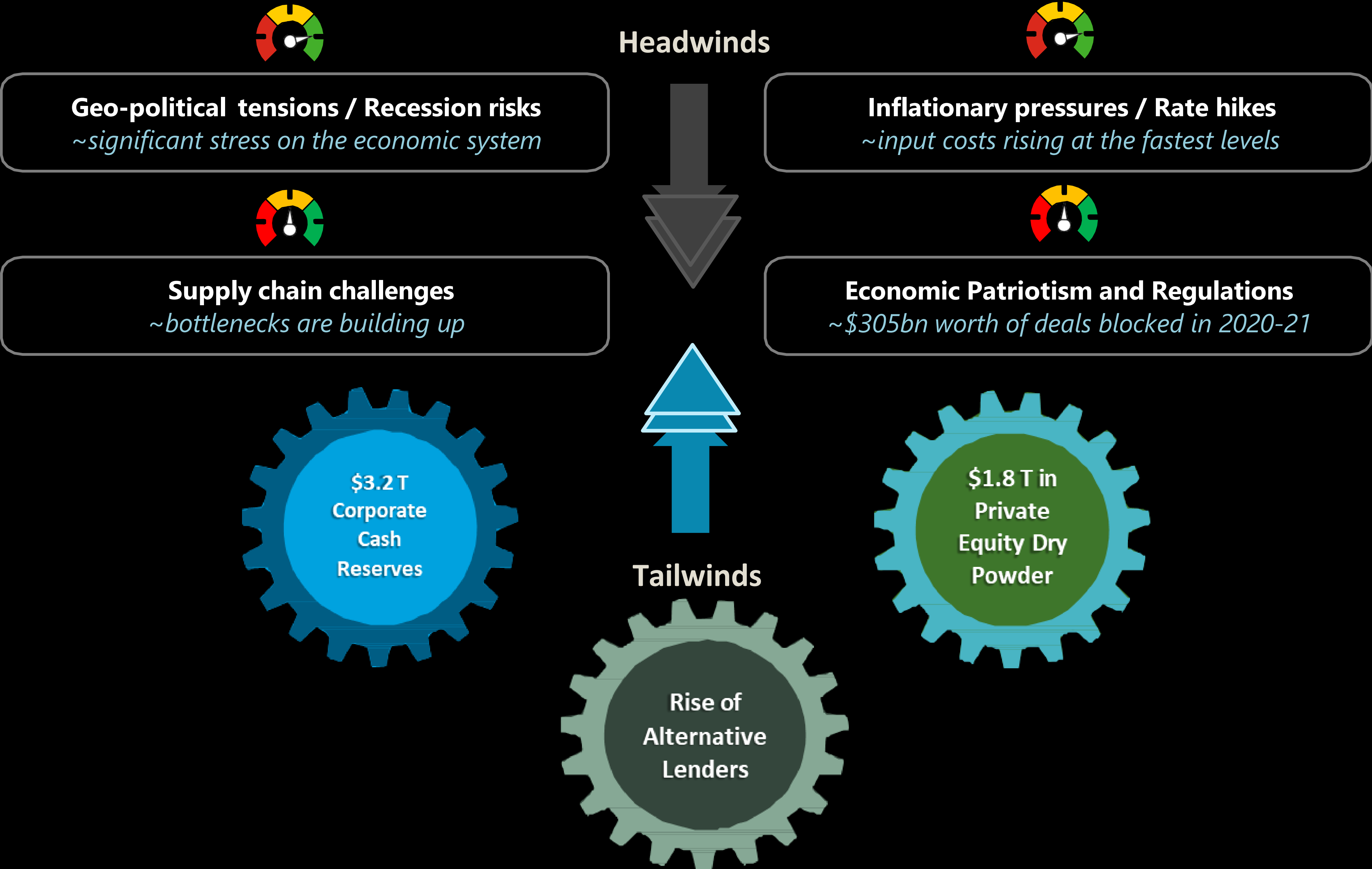
Looking Ahead: M&A markets are rapidly changing



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Looking Ahead: M&A markets are rapidly changing

Implications for M&A markets

1. **Synergy Realization and Value creation**: Companies will need to accelerate synergies realisation to demonstrate the value creation potential of M&A deals to their shareholders and activists.
2. **Portfolio realignment:** Many companies may also need to re-align their portfolio for the 'new normal' conditions, shed non-core assets and acquire new assets to optimise their business model.
3. **New trade lanes:** Geopolitics and supply-chain pressures are forcing companies to reassess their traditional markets and explore new trade lanes, as well as double down investments in stable economies.
4. **Alternative debt markets:** Rising interest rates and tightening debt markets means companies need to rethink their debt strategies. Last year saw record levels of non-bank lending, we expect alternative lenders will emerge as a central feature of M&A markets.
5. **Rise of alliances**: The structural changes across sectors are increasingly necessitating the expansion of traditional M&A strategies to include collaborative structures such as JVs, and alliances that are not bound by sector boundaries, but focus on purpose and values.
6. **Convergence and business model shifts:** Post-pandemic technology-led disruption is fuelling cross-sector convergence and companies need to recalibrate their M&A strategies to take advantage of such opportunities.
7. **Profits with Purpose**: The market expects companies to factor in ESG investing and impact investing as core to their growth. Dealmakers need to factor in this shift and develop dedicated M&A strategies.

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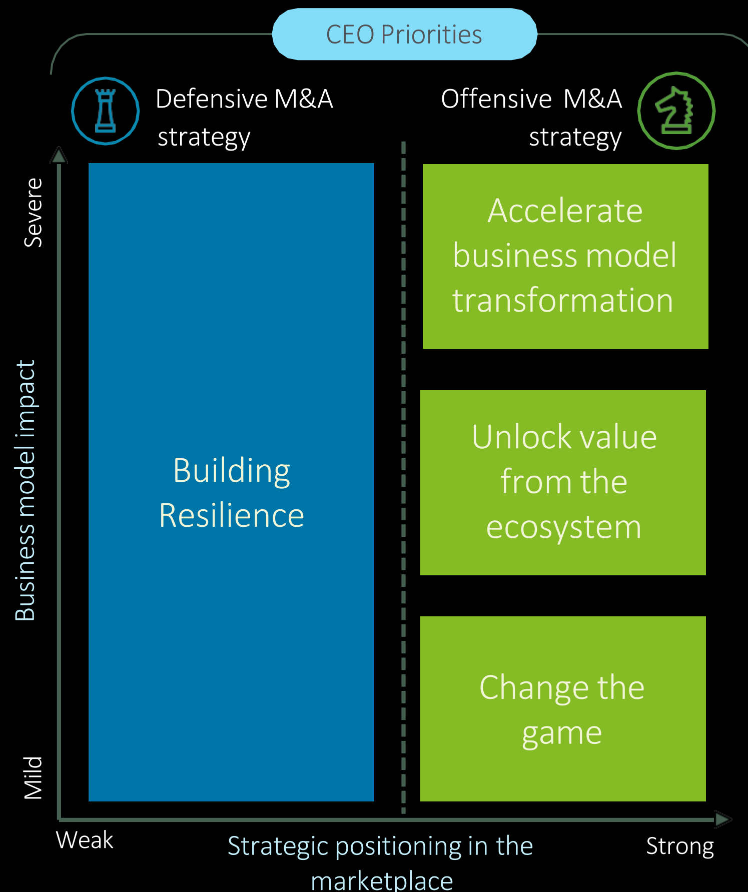
Charting New Horizons: Path to Thrive

Dealmakers need to adapt to new realities and shifting priorities of business resilience and new growth acceleration

What does 'Thrive' mean in the context of M&A Strategies

M&A strategies are now firmly cemented as a fundamental part of the corporate arsenal. This framework and accompanying deal archetypes can help companies ideate a new combination of M&A strategies, both in defense to preserve value and in offence, to drive transformative growth. Thriving in these 'new normal' conditions means companies need to build **resilient businesses** that can withstand macro shocks, **accelerate the business model transformation** and look for new growth opportunities resulting from **cross-sector convergence.**

We expect sectors to evolve at different trajectories and paces. At the same time, technology-enabled convergence is blurring traditional sector boundaries and creating new market opportunities and customer segments.



Building a resilient company

- Accelerate synergy realization from recent deals, evaluate your current portfolio and divest assets that are not aligned to long-term growth
- Optimize your portfolio and strengthen your core by acquiring competitors to consolidate the marketplace
- Consider opportunistic deals to secure your supply chain systems, safeguard your customer channels and enhance market positioning.

Charging the growth engine

- Transform your business model by acquiring value-enhancing products and capabilities. Identify portfolio gaps and consider expanding towards market adjacencies through acquisitions in digital, ESG and platform plays
- Capture opportunities through purpose-led alliances and partnerships involving non-traditional peers and scale-ups from the ecosystem
- Invest in disruptive innovation assets to scale at the "edge"

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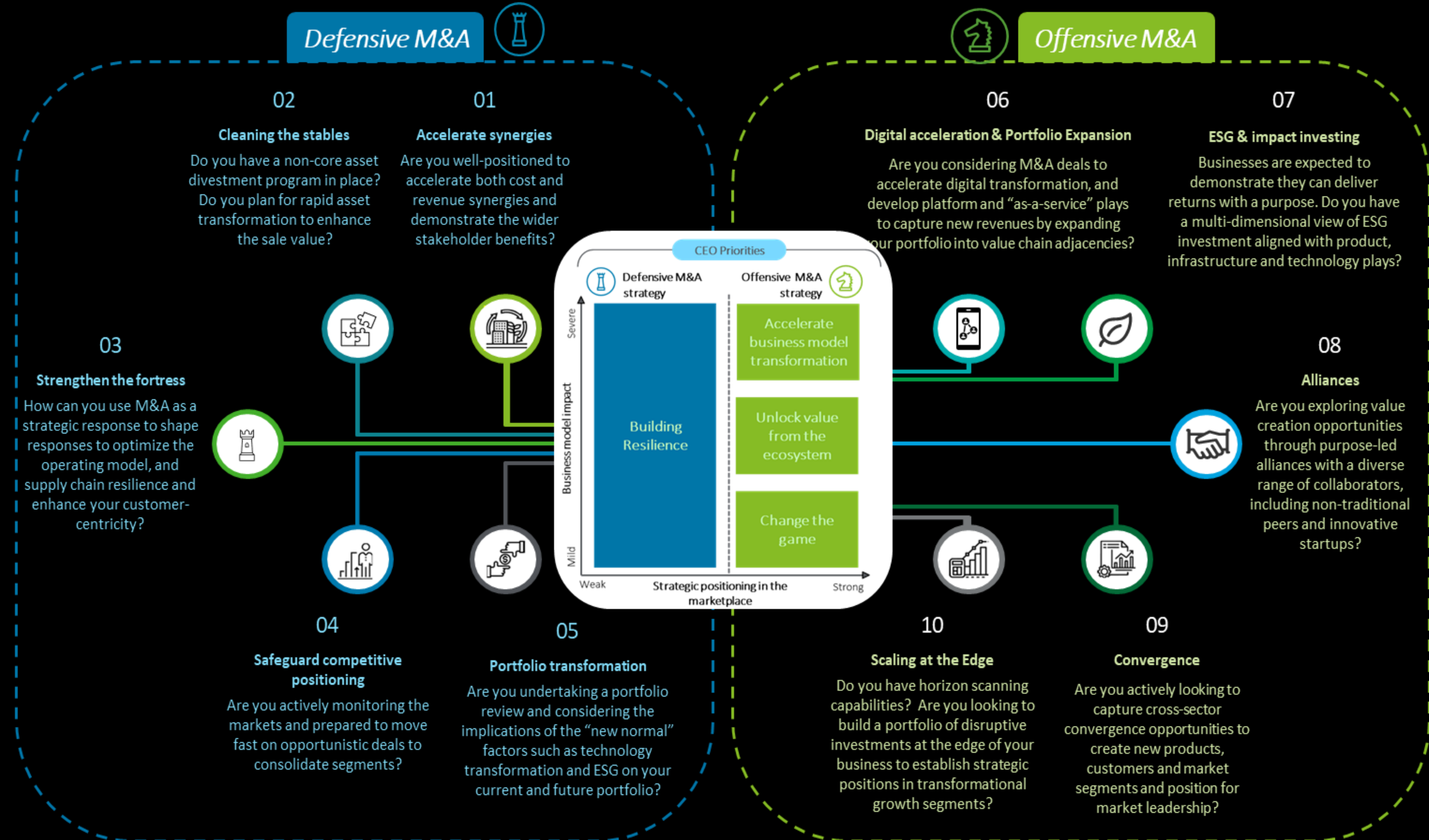
Charting New Horizons: Path to Thrive

10 key considerations to recalibrate your M&A strategies for thriving in the new normal conditions



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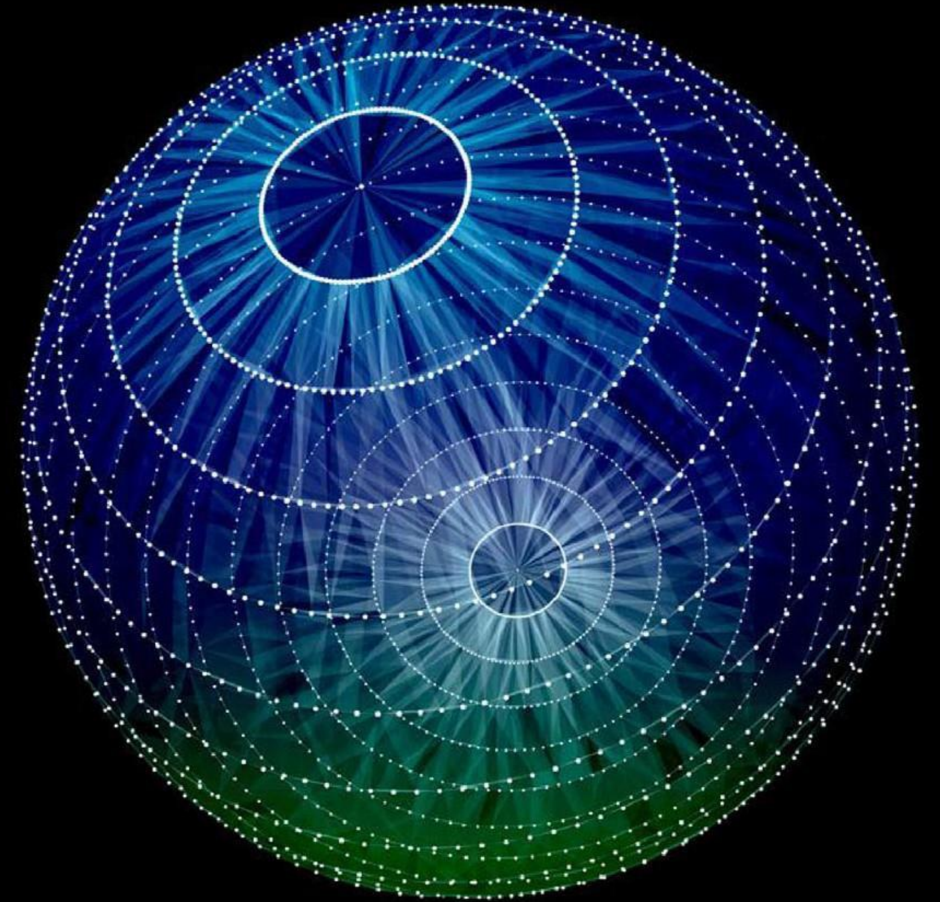
Sector M&A Pathways



Sector M&A pathways – Consumer & Automotive

Observations

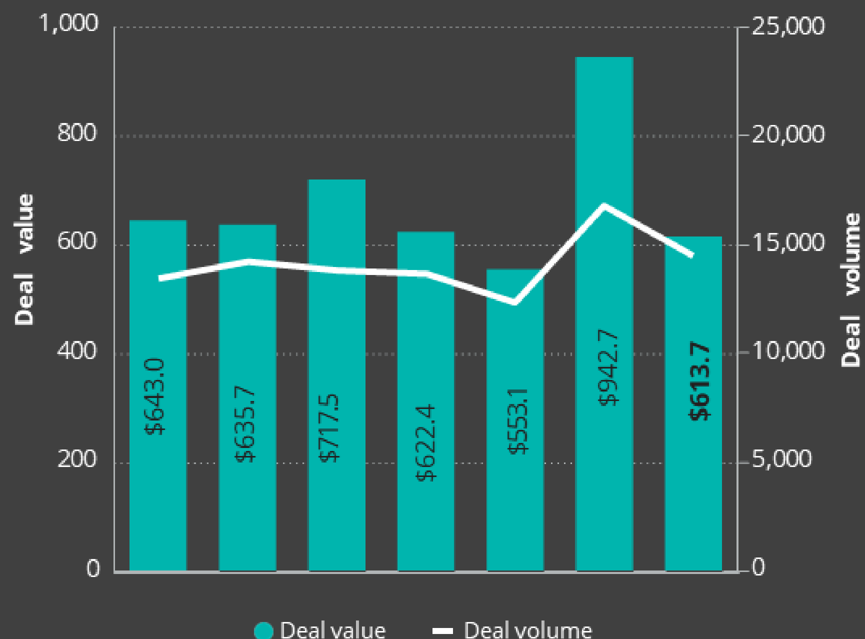
After a record year in 2021, the Consumer sector saw YoY decline of 35% in M&A value to $614B in 2022.

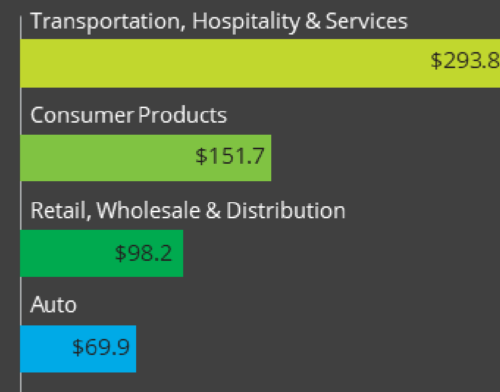
In terms of M&A volume, Europe was the most active region with 5,724 deals, followed by Asia-Pacific (4,201 deals) and North America (3,697 deals). Europe was the most targeted region with $209B worth of deals in 2022.

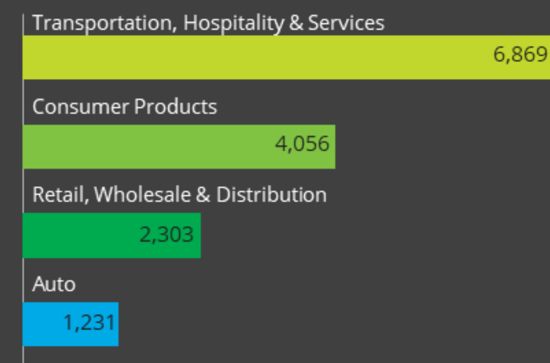
Transportation, Hospitality & Services was the most active subsector with $294B worth of deals, while Automotive saw the highest YoY decline of 61% to $70B in 2022.

Some of the likely drivers for M&A activity in 2022 include:

- Building resilience against inflation and supply chain disruptions
- Evolving preferences in retail and consumer goods (e.g., omnichannel, delivery logistics, sustainable products, emerging tech, hot markets, such as health and wellness)
- In the automotive sector, the generational shift to electric vehicle (EV) and associated supply chains and building resilient business models by divesting noncore assets such as dealer networks
- Trends toward nearshoring and digitization in the Logistics and Transportation sectors







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Sector M&A pathways – Consumer & Automotive

Consumer

Forces shaping "new normal" conditions

Pressure on margins

- Surges in inflation, customer demand, supply chain disruptions, and higher labor costs are leading to rapid increases in production costs and pressure on margins.

Direct-to-consumer (D2C) purchases will increase

- D2C models will enable companies to increase customer-centricity through personalization, loyalty programs, and increased customer service levels.
- More companies will look to be active in the D2C space and acquire platforms to increase scale of distribution.

Sustainability and wellness influences purchasing behavior

- Consumers are increasingly willing to pay a premium for socially conscious products, ethical supply chains, and wellness-focused offerings.
- This trend is creating opportunities for new revenue streams.

Slower recovery in some subsectors

- Post-pandemic uncertainty continues to affect the leisure, travel, and hospitality sectors.
- Revenue losses in these sectors, originally from the pandemic but now from inflation, could contribute to an increase in sales of distressed assets and restructuring.

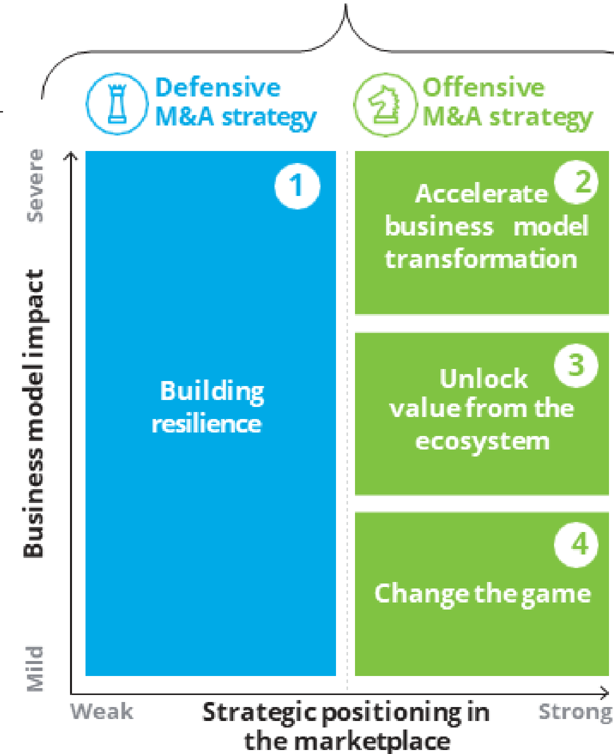
Short-term responses

1 Supply chain resilience

Companies could consider investing in contingency supply chains, this includes considering partnerships with new suppliers, as well as with private equity to bolster supply chain systems.

2 Technology-led transformation

Digital transformation is fundamental to success. In addition to omnichannel capabilities, companies should consider investments in predictive demand analytics, fulfillment, and dynamic pricing.



Medium-term responses

3 Pursue alliances

Companies could consider alliances with their peers to alleviate supply side pressure, as well as cross-sector arrangements with sectors like technology to enhance customer experience.

4 Growth investments

Companies could consider an ESG-aligned investment strategy to target assets such as sustainable product design and packaging as well as, in emerging growth segments such as personalized nutrition and carbon-neutral travel.

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Sector M&A pathways – Consumer & Automotive

Automotive

Forces shaping "new normal" conditions

Connectivity is becoming standard

- The majority of cars are expected to have smart connectivity by 2035, driven by consumer demand and regulation.
- Data generated by 5G connectivity will be valuable and utilized by OEMs, dealers. Fleet owners, and consumers.

Shared mobility and mobility-as-a-service continue to grow

- Shared mobility market continues to grow, driven by need for convenience, lower costs, and environmental concerns.
- Customers are using mobility platforms in an increasing variety of ways, including for grocery delivery, courier, and others.

Investment for autonomous vehicles (AVs) remains steady

- Both OEMs and tech companies are investing heavily in autonomous vehicle technologies. However, mass adoption remains distant owing to safety concerns.
- Stakeholders need to work closely with governments to shape future regulations that strike the balance between innovation and safety.

Electric vehicle and fuel- cell ecosystems

- The EV market and associated ecosystem are expected to grow in double digits driven by customer preferences, favorable regulation, private capital investment, and the strategic push by OEMs.
- Hydrogen fuel-cell powered vehicles are starting to make up a more meaningful portion of the market.

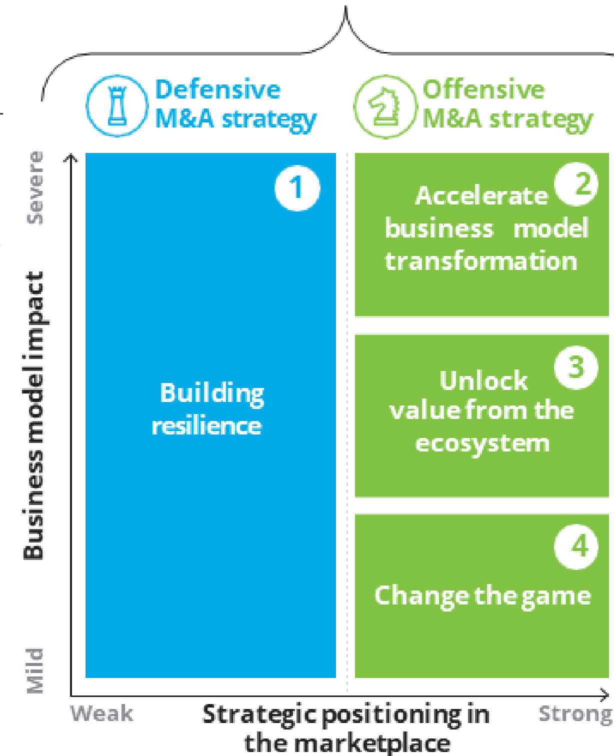
Short-term responses

1 Safeguard supply chain

Supply chain disruptions may prompt OEMs to vertically integrate critical aspects such as chips and divest auxiliary services such as auto financing, retail insurance, etc. to facilitate these critical investments.

2 Agile business models

Companies should consider investments across the entire value chain to make the business more agile; these include opportunities for digitization, flexible manufacturing, and smart factories.



Medium-term responses

3 Software-centric partnerships for CASE development

Access to a comprehensive software suite is critical to success for driving Connected, Autonomous, Shared, and Electric (CASE) products. OEMs should explore alliances and partnerships to drive this forward.

4 Future portfolio realignment

Companies need to continue building a future portfolio that aligns major shifts in consumer trends. This could include value chain opportunities such as smart infrastructure, recycling, and sustainable materials.

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Sector M&A pathways – Energy, Resources & Industrials

Observations

After a record year in 2021, Energy, Resources & Industrials (ER&I) in 2022 stabilized with a 29% YoY decline in deal value to $816B and 11% YoY decline in volume to 12,547 transactions.

North America with $308B worth of deals was the most active region with respect to deal value, while Europe with 4,254 deals led in terms of deal volume in 2022.

The oil and gas industry earned record profits in 2022, providing ample cash flow to fund its strategies in 2023. Energy transition is the primary driver of M&A activity as oil and gas companies look at shifting their portfolios toward clean energy.

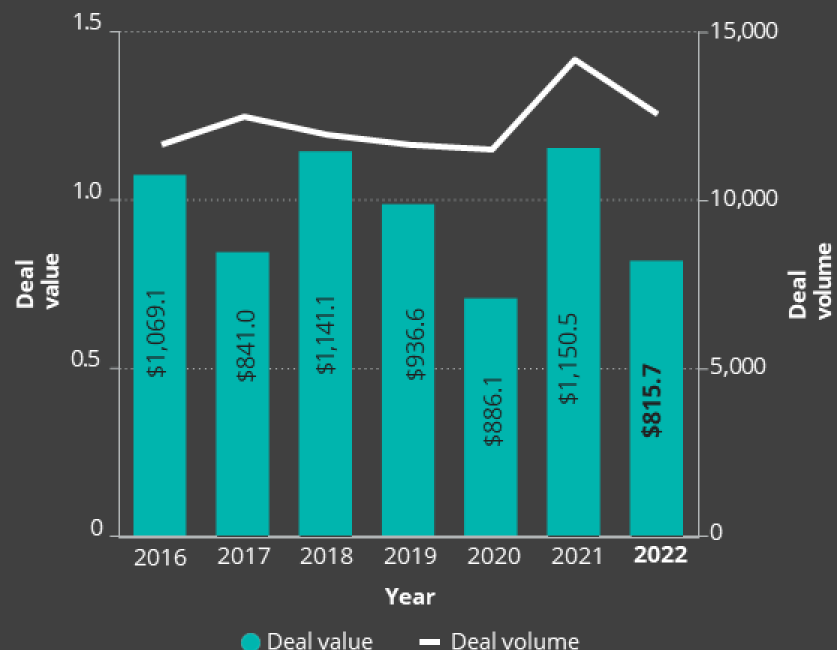
ESG growth areas such as carbon capture, hydrogen, renewables, and other clean technologies are expected to be key focus areas.

The sharp rise in global energy prices fueled by the Russia-Ukraine conflict may drive consolidation within the Oil, Gas & Chemicals subsector.

Industrial Products & Construction M&A activities are anticipated to pick up as companies invest in new capabilities such as digital, smart factories, and supply chain.

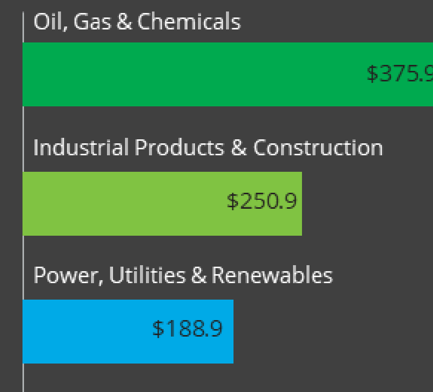
Energy, Resources & Industrials deal value and volume

(in trillions of US dollars)

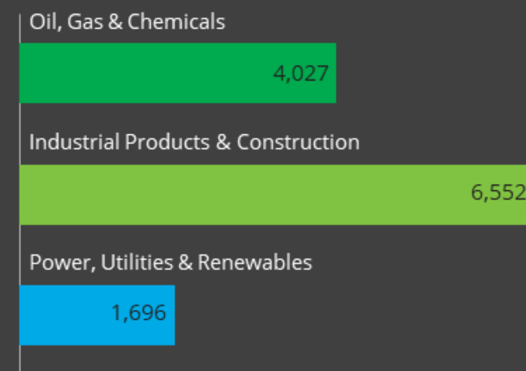


Deal value by sector

(in billions of US dollars)



Deal volume by sector



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Sector M&A pathways – Energy, Resources & Industrials

Energy & Resources

Forces shaping "new normal" conditions

Increased demand and constrained supply are driving changes

- A combination of supply constraints and geopolitical tension has resulted in energy price increases and is putting pressure on operating models that had become lean in recent years offset with low prices.

Decarbonization across industries is enabling new energy era

- Decarbonization mandates are gaining pace in all industries and present the opportunity for E&R companies to deliver scale projects and contribute to a low- carbon future.

Green jobs will require new skills in the workforce

- Decarbonization commitments, flexible workforces, and requirements to reskill for digital and renewable capabilities will require companies to design new talent models.

Active portfolio monitoring

- Companies will need to monitor their portfolios to avoid carrying stranded assets as well as avoid unnecessary divestment of assets that may prove profitable in other supply/demand environments.

Importance of customer- centricity will increase

- To thrive throughout the energy transition, fuel companies will need to offer a full suite of products and services.
- Companies will look to draw closer to end customers and incorporate convenience as key to the customer experience.

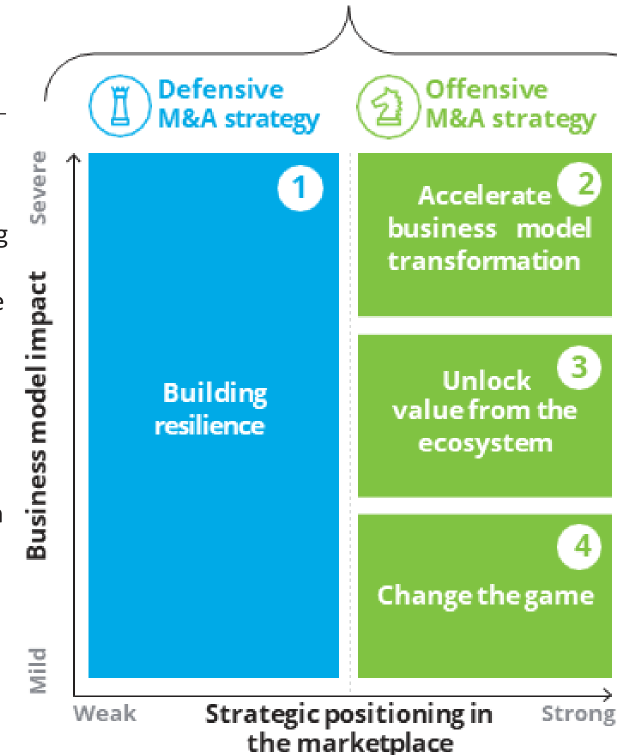
Short-term responses

1 Portfolio restructuring to drive energy transition

Companies are fundamentally rethinking their portfolio, seeking to divest higher carbon-intense assets, pursuing acreage consolidation, and acquiring assets aligned to energy transition.

2 Investments to build future capabilities

Companies could use of the current high energy prices to make significant investments and acquisitions related to digitization and integrated value chain driving new revenue streams.



Medium-term responses

3 Energy transition alliances

The energy transition is attracting investments from nontraditional competitors in other sectors, as well as private capital. Companies should consider cross-sector alliances with companies in automotive, technology, and other sectors to gain direct access to customers and explore new revenue models.

4 Sustainability-aligned growth segments

Companies should actively seek opportunities in adjacent markets such as chemicals, advanced plastics recycling and others where they can leverage existing expertise such as research and development and customer networks.

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Sector M&A pathways – Energy, Resources & Industrials

Industrials

Forces shaping “new normal” conditions

Technology is driving industrial connectivity

- Advancements in the Industrial Internet of Things (IoT) and digital twin technology are driving significant innovation in solutions and business models.

Supply chain disruption is affecting production times

- Long lead times for critical components are creating uncertainty in production planning and forecasting.
- Delays in manufacturing and port congestion will drive companies to identify resilient solutions for supply networks.

Rising raw material costs are affecting margins

- Shortage of supply along with increases in raw material costs and shipping rates have created pricing pressures.
- Unless contained, these cost rises threaten to outstrip the productivity gains and could significantly affect profit margins.

Digital solutions will lead to workforce evolution

- Digital-first solutions will affect the skill sets required from the workforce.
- Industrial companies will compete with tech firms for talent, while simultaneously upskilling their current workforce.

ESG pressures will continue to grow

- Stakeholders will increasingly call for ESG commitments.
- Creating the factory of the future through smart technology and green energy will remain in focus.

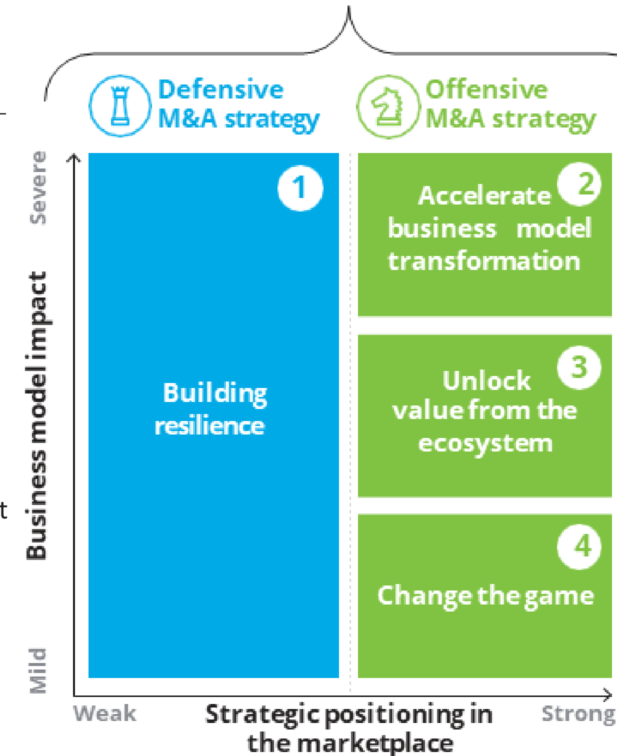
Short-term responses

1 Strengthening of value chain

Acquisitions and investments related to vertical integration could help companies secure long-term suppliers and mitigate supply chain disruptions.

2 Shifts in core competencies

The inevitable shift toward sustainable processes and products is likely to affect the core competencies of many companies, and they should drive this change through targeted acquisitions.



Medium-term responses

3 Technology alliances

Industrial companies should consider alliances with the technology sector to boost innovation and leverage specialist digital skills expertise.

4 Investing in disruptive technologies

Industrial companies should consider growth acquisitions in focused areas such as IoT, robotics, automation, digital twin, and AI to drive long-term transformation.

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Sector M&A pathways – Financial Services

Observations

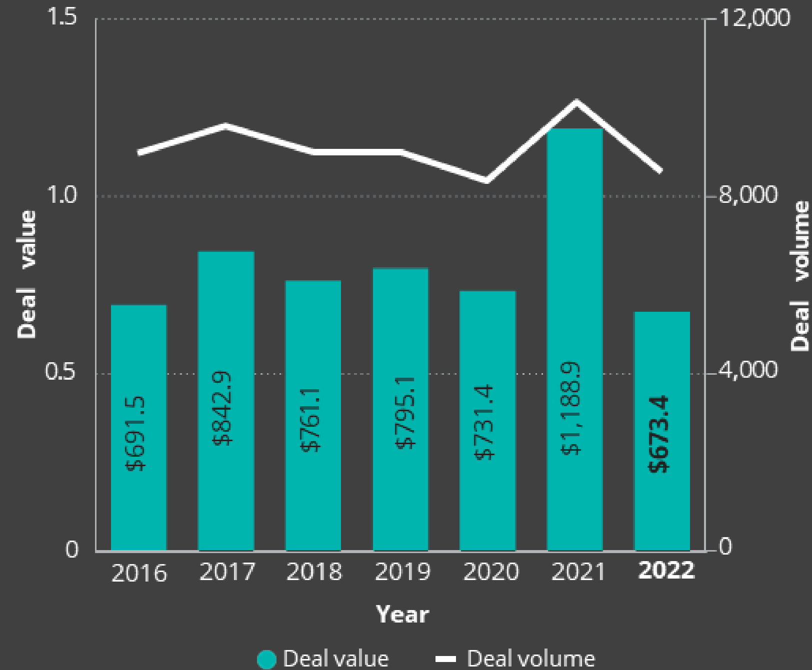
After the highs of 2021, the financial services sector registered a 43% YoY drop to $673B worth of deals in 2022, the lowest value seen in the past five years. Deal volumes also saw a YoY decline of 15% to 8,589 transactions in 2022.

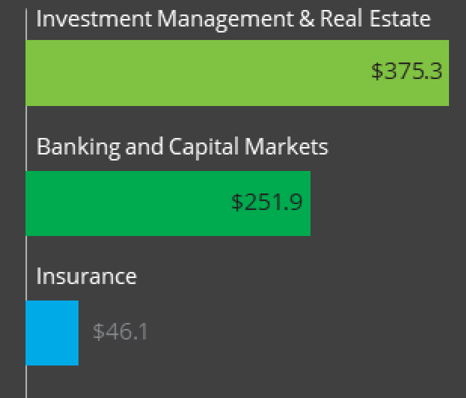
Europe was the most active region in terms of deal volume with 2,973 transactions, followed by North America (2,579 deals) in 2022.

Inflation hampers nonlife profitability even while boosting prices and top-line growth. The insurance sector should be looking to use M&A to broaden its historical focus from risk and cost reduction to prioritize ongoing innovation, competitive differentiation, and profitable growth.

In the short term, the banking sector is likely to reap benefits from interest rate hikes and higher savings; over the long term, the sector will need to pursue new sources of value beyond product, industry, or business model boundaries. This is likely to drive divestment of noncore assets and investments in new applications for ESG, embedded finance, and digital/fintech assets.

Investment management firms are likely to continue investments and acquisitions in digital transformation with new technologies that improve the client experience, gain operational efficiencies, and potentially generate alpha returns.





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Sector M&A pathways – Financial Services

Banking & Securities

Forces shaping “new normal” conditions

Skewed balance sheets are resulting in declining ROE

- Banks have divested noncore assets from their portfolios, resulting in a skewed balance sheet with legacy products.
- Growth will be required to deliver more stable return on equity (ROE)s.

Stakeholders demand ESG commitments

- Increased scrutiny from clients, regulators, investors, and employees on companies’ ESG commitments will affect business models for financial institutions.

Digital assets, blockchain technology, and cybersecurity are increasing in importance

- The introduction of new, disruptive products and technologies has led to banks investing heavily in new technologies and creating alliances with partners that have broader digital capabilities.
- Banks are shifting toward integrated platforms and cloud solutions to improve cybersecurity and enhance analytical capabilities.

Regulation will continue to influence the market

- Regulators are expected to respond to rapid developments in the sector with the introduction of new rules, especially in the areas of digital assets, climate, and financial inclusion.
- Regulatory convergence is increasingly desired by central bankers and could have a major impact on competition and market strategies.

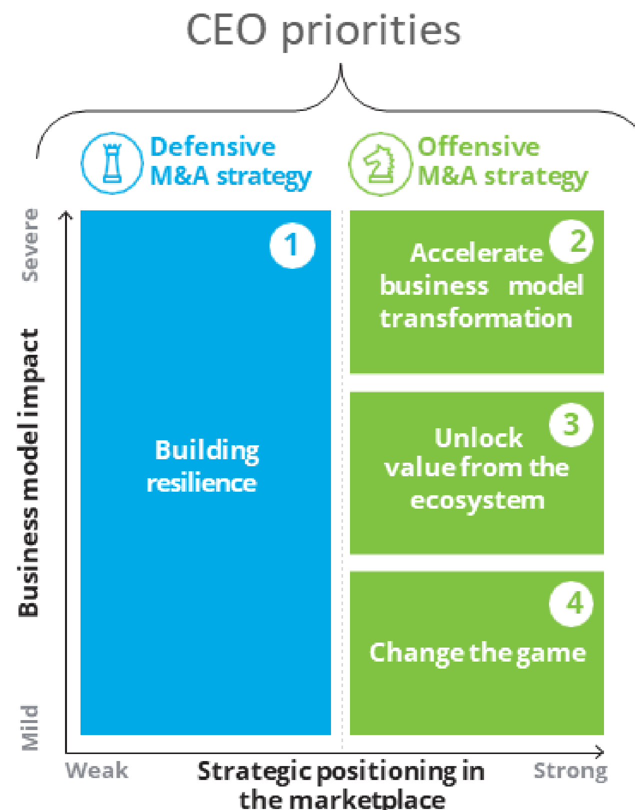
Short-term responses

1 Divestment of noncore assets

Companies could consider divesting underperforming loan portfolios and noncore divisions to raise capital and improve efficiency.

2 Technology-led business transformation

Investments and acquisitions of new technologies (e.g., digital payments, e-trading platforms) will be critical to position banks to compete in the future.



Medium-term responses

3 Cross-selling opportunities

Banks need to establish alliances outside of their core sector with players from technology, retail, health, and others to cross-sell new services to a wider customer base, introduce new capabilities, and improve utilization of their current assets.

4 Growth investments

Banks also need to consider acquiring high-growth, innovative businesses in areas like cybersecurity, fintech platforms, blockchain, AI, and others in adjacencies that could, in time, become the new core.

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Sector M&A pathways – Financial Services

Investment Management

Forces shaping "new normal" conditions

Shifts in customer demand are driving new business models

- Customers are increasingly demanding specialized and value- add services.
- Firms are using digital channels and process automation to enhance client interactions.

Regulators are focusing on customer protection

- Regulators are likely to focus on increased client protections in areas such as data privacy, fee transparency, product unbundling, and ESG offerings.
- Lack of alignment could result in regulation asymmetry across jurisdictions.

Demand for digital assets will require new capabilities

- Increasing interest in digital assets (e.g., crypto, non-fungible tokens [NFTs]) requires firms to develop or acquire new technologies and product offerings.
- These new offerings will also increase the importance of cybersecurity capabilities.

ESG will affect asset allocation

- The focus on ESG will affect investment allocation decisions, investment transparency, regulatory reporting, and product marketing decisions. It will also likely drive product innovation in this segment.

Performance pressures are affecting allocations

- The alternatives market has gained wide acceptance as it offers portfolio diversity and higher returns. This is placing further pressure on allocations and integration with traditional asset classes.

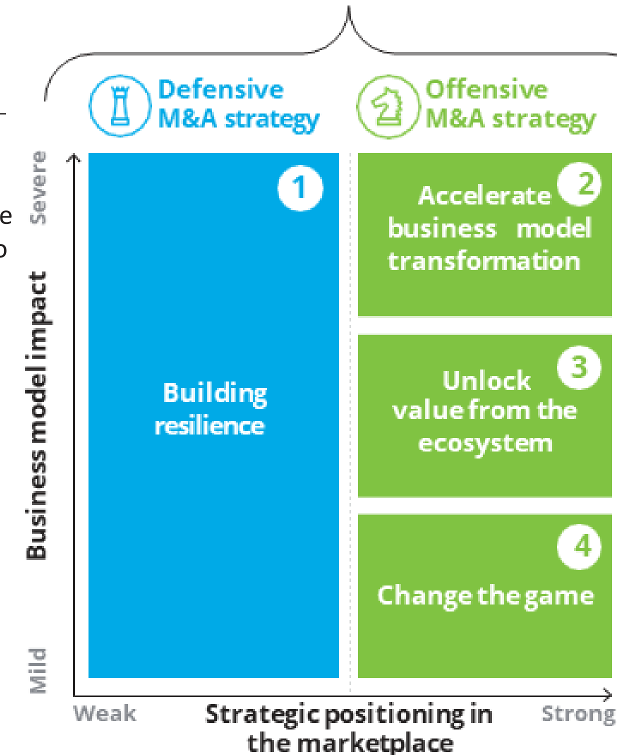
Short-term responses

1 Consolidation

Sector is ripe for further consolidation, and in recent months, major players have been rapidly consolidating in response to falling fees and lack of growth.

2 Bolt-on capabilities

Investment management firms are pursuing M&A to acquire new capabilities such as ESG investment specialization and technologies such as automated portfolio platforms (robo-advisors).



Medium-term responses

3 Nontraditional alliances

Firms need to consider alliances outside of their core activities to expand their current client base, skills, and product offerings.

4 Future portfolio

Firms also need to consider acquisitions of high-growth, innovative businesses in adjacent growth areas such as crypto funds, NFTs, crypto asset management platforms, and others.

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Sector M&A pathways – Financial Services

Insurance

Forces shaping "new normal" conditions

Reduction in property and casualty (P&C) business volumes will drive innovation

- Reduction in traditional volumes and pricing pressures are forcing P&C insurers to focus on innovative offerings such as usage-based insurance and sensor enabled analytics.

Customer-centric business models

- Customers are increasingly expecting an elevated customer experience, forcing investment in analytics and new product development.
- Convergence of insurance with digital health platforms is giving rise to new customer product categories and untapped market segments.

Emerging talent model

- Pressure on growth is forcing insurers to develop innovative operational solutions.
- This is leading to investment and hiring of skilled workforce in new areas such as digital, cloud, automation, risk controls, and customer analytics.
- Insurers need to foster a flexible and agile workplace culture for such fresh talent to thrive.

ESG is more than a 'brand' play

- For insurance companies, ESG principles will underpin the new emotional contract.
- Insurance companies are uniquely placed to influence ESG mandates on global businesses given their role in underwriting industrial activities for other companies.

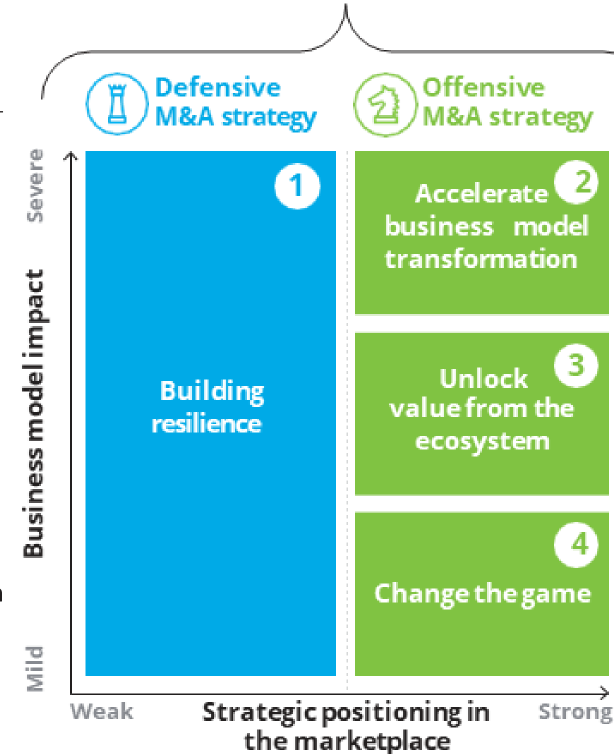
Short-term responses

1 Portfolio rebalancing

Market uncertainties resulting from geopolitical conflict and the need for capital optimization may prompt insurers to divest noncore assets and exit underperforming markets.

2 Market consolidation

Costs of legacy business models and operating pressures are likely to drive consolidation in the market in order to capture economies of scale and accelerate transformation by investing in digital assets and analytics capabilities.



Medium-term responses

3 New alliances

Insurers could actively look for partnerships in the technology, health, and communication sectors to address needs for a holistic solution.

4 InsurTech segment

After years of investment and scaling up, the InsurTech sector is at a stage of maturity where consolidation is to be expected; insurers could also focus on the new segment of InsurTech that uses third-party data to disrupt underwriting and pricing.

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