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M&A Trends Report, Mid-year 2016

Our annual comprehensive look at the M&A market

Another year of unlocking deals

Table of contents

Executive summary

"We are seeing significant optimism in continued M&A activities, but global growth concerns have started to dampen the recent pace of activity."

—Russell Thomson, national managing partner, M&A Services, Deloitte & Touche LLP

The past year marked the busiest ever for mergers and acquisitions (M&A). During the frenetic 12 months, U.S. companies announced more than $2.1 trillion in transactions.[1] Global M&A volume topped $4.7 trillion in aggregate.[2] To put that number in context, the worldwide total exceeded the gross domestic product (GDP) of all but two nations.[3] The $4.7 trillion tally was a significant increase over 2014's $3.4 trillion and surpassed the previous annual record set in 2007.[4] Despite the slowdown in the first quarter of 2016, executives at US corporations and private equity firms predict that the pace of M&A activity will continue—or even ramp up—according to Deloitte's third annual *M&A Trends Report.*

Of the nearly 2,300 survey respondents from U.S. corporations and private equity firms, an overwhelming majority—87 percent—said they expect their deal activity to sustain or better 2015's record pace. A number of factors are driving the optimism, creating an environment ripe for deal-making. Many companies are still flush with cash, even after drawing some of it down over the past year. Stocks remain at relatively high levels after recovering from recent bouts of volatility. Interest rates are still at historically low levels and debt markets have slightly rebounded—enabling companies and PE firms with access to capital to continue doing deals.

Also, boundaries are increasingly blurring between industry sectors as technology penetrates and reshapes traditional business models. For instance, banks are working to deepen their capabilities by acquiring financial technology firms,[5] while automobile companies have turned their attention to connected vehicles.[6] The convergence of technology across industries is adding a new dimension to deal-making.

Those factors, along with others, could converge to push past a relatively lackluster start to the year and potentially continue to drive strong M&A activity. 2016 began with more of a whimper than bang. US deal volume dropped 40 percent in the first quarter of 2016, compared to the first quarter of 2015.[7] In our survey, half of private equity investors (PEIs) anticipate an increased number of deals this year, but that is notably less than the 61 percent that foresaw an increase in activity in our 2015 survey. Our respondents flagged as caution signs a number of looming concerns—especially the global economy—that could sour the appetite for takeovers or make smaller, acquisitions more likely than large transformational deals.

Among the key findings in our 2016 *Trends* report:

- **Deal activity is expected to remain strong.** Among both corporate executives and private equity investors (PEIs), almost nine in 10 respondents expect deal activity to continue at the same pace or increase. Private equity investors were the most optimistic, with 52 percent anticipating they will actively pursue a greater number of deals over the next year, versus 43 percent of corporate respondents. Nonetheless, PEIs were less bullish than they were one year ago, as noted above.

- **Corporations see an increase in both smaller strategic deals and major transformational deals.** As respondents look at the next 12 months to take advantage of favorable opportunities, 34 percent will look for smaller strategic deals (up from 26 percent in 2015), while another 26 percent indicate they will seek major transformational deals (up from 21 percent in 2015).

1 Thomson Reuters
2 http://www.wsj.com/articles/will-the-new-year-be-sweet-16-for-deals-1451557804
3 http://data.worldbank.org/indicator/NY.GDP.MKTP.CD
4 http://www.wsj.com/articles/broken-deals-rein-in-a-strong-m-a-market-1420155330
5 http://techcrunch.com/2016/04/19/banks-and-fintech-in-2025-an-unlikely-alliance/
6 http://techcrunch.com/2016/01/19/whos-driving/
7 http://www.usatoday.com/story/money/2016/03/24/sorry-wall-street-m-down-40/82174880/

- **Companies are holding steady in looking abroad.** Both corporate executives and private equity investors are continuing at the same pace as 2015 in sourcing foreign targets (75 percent and 84 percent, respectively).

- **More divestitures planned for 2016.** Fifty-two percent of corporate respondents—up from 39 percent a year ago—said their company plans to pursue divestitures to shed non-core assets in the year ahead, help focus their business, and in some sectors, to raise capital.

Against this optimism, respondents chose economic conditions as the top factor likely to determine deal success in 2016—the first time that's been the case in the history of our survey. Global economic uncertainty was also seen as having the biggest influence on companies' ability to pursue, finance and close deals in the next 12 months.

As we did in last year's report, we identified the industries that are expected to generate the most M&A activity in the year to come—namely, technology, oil and gas, financial services, and health care—as well as the drivers behind the stepped-up expectations.

Through the responses of the corporate and private equity executives that participated in our third *Trends* report, we're also able to glean some interesting insights about analytics and other factors in the M&A environment. We're thrilled to share these results with you and hope you find them instructive as you develop your growth strategy and evaluate, close, and integrate your next M&A transaction.

Russell Thomson

Russell Thomson
National managing partner
Mergers & Acquisitions Services
Deloitte & Touche LLP

About the survey

From February 19 through March 15, 2016, a Deloitte survey conducted by OnResearch, a market research firm, polled 2,292 executives at US companies and private equity firms to gauge their expectations, experiences, and plans for mergers and acquisitions in the coming year.

On the corporate side, 1,790 respondents were senior executives at companies with at least $10 million in annual revenue. Respondents included companies in 49 states and Washington, D.C. Almost 60 percent of the respondents worked at publicly traded companies, as opposed to privately held businesses. One in four hailed either from California or New York. Texas, Illinois, Florida, New Jersey, Pennsylvania, and Ohio had the next highest concentration of respondents in descending order. In all, the top eight states accounted for half of the total responses.

More than a third of the company respondents were owners, board members, or C-suite executives; the remainder included managing directors, vice-presidents, department or business line heads, or managers.

Industry representation is diverse: the five with the largest representation were (in order): technology, banking and securities, retail, and distribution, process and industrial products, and consumer products.

The size of the companies that responded also was widely dispersed, with 30 percent with annual revenue in excess of $1 billion, roughly another 30 percent in the $250 million to $1 billion range of annual revenue and about 40 percent having annual revenue less than $250 million.

Of the almost 1,800 corporate executives surveyed, nearly all (89 percent) typically close at least one merger or acquisition a year. More than half (62 percent) of the companies said they close between one and five deals a year. Seven percent typically complete more than 11 deals annually. About two-thirds (63 percent) of the deals were less than $250 million in size, while 10 percent were at least $1 billion in size.

On the private equity side, 502 respondents were limited to senior officials of firms based in 43 states. More than half the firms were headquartered in California, New York, Florida, Texas and Pennsylvania.

More than 15 percent of private equity respondents hailed from firms with funds in excess of $3 billion, and 44 percent of respondents work at funds that ranged between $500 million and $3 billion. Forty percent of the PE firms controlled funds of less than $500 million.

Nineteen percent of the PE firms had portfolios that contained more than 40 companies. About half held stakes in between 10 and 40 companies. One-third of the PE firms held fewer than 10 companies in their portfolio.

The full survey results are included in the appendix; some percentages in the charts throughout this report may not add to 100 percent due to rounding, or due to certain questions giving survey participants the option to choose multiple responses. Also, year over year data with rounding may show a slight difference in numbers from previous M&A Trends reports.

Expectations high as conditions shift

Paced by consolidation within the technology, energy, and health care sectors, the market for mergers and acquisitions reached new heights in 2015. The year saw more than $2.1 trillion in transactions among US companies. And the cycle proved to be the biggest year ever for M&A transactions, with $4.7 trillion in deals consummated across the globe. Emerging from a global recession, deal-making has been on an upward trend, but the level reached last year was more than double that of 2009 surpassed the previous record set in 2007.[8]

The predominant view among corporations and private equity respondents in our survey is that the number of deals they plan to pursue in 2016 will match or exceed last year's pace. In our survey, more than 40 percent of corporate respondents said they expect the number of deals to increase over the coming year. Virtually the same proportion see little to no change in deal volume through 2016. Fifty-two percent of private equity investors anticipate seeking more deals over the next 12 months, a significant decrease from 2015, when that number reached 61 percent. Still, fewer than 10 percent of respondents from either segment of survey-takers said they expect a dip in the number of transactions their company is likely to pursue in the coming year.

On the corporate side, only 9 percent of respondents expect the average number of deals to decrease—the figure was just 6 percent in our last two surveys. The percentage of private equity investors that don't expect significant M&A activity over the next year increased slightly compared to 2015. Six percent of PEIs expect their deals to decrease, up slightly from 2015 where only 3 percent expected decreases.

But private equity still anticipates a strong year. More than half of those respondents (53 percent) predict that their firms' acquisitions over the next 12 months will average $500 million or more, continuing a trend that has held steady since our first survey in 2014.

"There's a lot of positive momentum in the market. Combined with the dry powder private equity has and the fact that debt markets appear to be gradually stabilizing, we anticipate continued activity among these investors."

—Barry Curtis, partner, Deloitte & Touche LLP

Outlook for more deals in the coming year

87% of corporate and private equity executives expect deals to continue at the same pace—or to increase.

[8] http://www.wsj.com/articles/will-the-new-year-be-sweet-16-for-deals-1451557804

New targets for consolidation

By sector, technology continues to be the most attractive overall industry for corporate M&A activity, with 26 percent of respondents predicting it will be the most active sector over the next 12 months. That figure was down slightly from 2015, as were results for the oil and gas industry, the second-most probable area for M&A activity, according to 22 percent of corporate respondents.

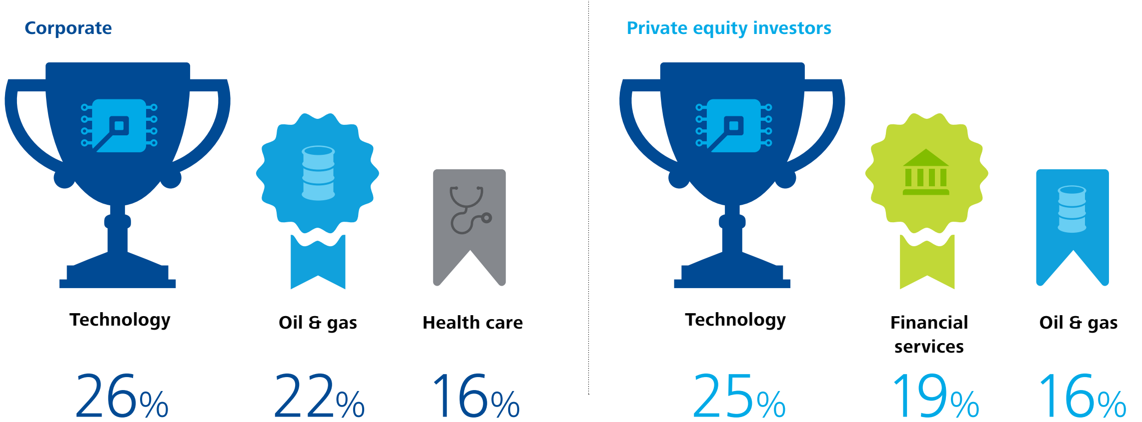
Despite recent volatility in oil prices, the industry has been fairly resilient and could see significant deals in the coming months, according to Trevear Thomas, principal, Deloitte Consulting LLP. "We could see a lot of activity in the M&A market with Tier 1 assets ripe for acquisition. Scale matters, especially in this oil environment, and that leads to further consolidation."

Though predictions for deal activity in technology and energy were down slightly this year, corporate respondents predict that several industries will see a slight bump in activity over the next 12 months. Industrial manufacturing, life sciences and construction all were up by two percentage points this year as top industries for M&A activity among corporate survey-takers.

On the private equity side, technology was by far the most likely sector to see growth in transactions—one-quarter of respondents anticipated that it would be the number one industry for mergers and acquisitions in the coming year. Financial services and the oil and gas industries were noted as the most likely sectors for M&A activity among private equity respondents.

"The convergence of technology and traditionally analog industries is adding a new dimension to deal-making. For instance, banks are working to deepen their capabilities by acquiring financial technology firms, automobile companies have turned their attention to connected vehicles, and similar activity is happening in health care. As sectors converge with technology, the strong impacts tech deals have on financial markets will continue, and analyzing deal activity will need to evolve to account for the new hybrid sectors emerging," adds Russell Thomson, National M&A Managing Partner, Deloitte & Touche LLP.

Top industries for 2016 M&A activity

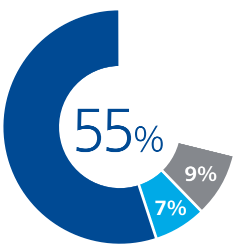


Focus on paths to growth

Since our inaugural report in 2014, private equity firms have progressively become more involved with their portfolio campaigns. Eighty-nine percent of the 2016 respondents said they were actively or very actively involved in their portfolio companies' management, compared to 77% who were active or very active in 2014.

In addition, the majority of private equity deal-seekers (55 percent) anticipate they will close at least six add-on deals for their portfolio companies over the coming year, with 7 percent of those respondents expecting to close more than 30 such deals over the next 12 months. Only 9 percent of private equity investors say they don't expect any activity in add-on deals this year.

Add-on deals



55% of private equity investors anticipate closing at least 6 add-on deals. 7% expect to close more than 30 such deals. Only 9% anticipate no add-on deals.

This year's survey results also indicate that fewer corporations are operating without a strategy to guide their M&A activity than in the past 2 years.

Corporations are placing more emphasis on developing an MA strategy in 2016. While 17 percent of the respondents reported having no M&A strategy in 2014, that number dropped to only 3 percent in our most recent survey.

Active Portfolio management

Private equity investors

89%

Up from 77% in 2014

The outlook for corporate deals over the next 12 months is tied in large part to the desire to build new business in existing markets, which has been the leading M&A objective for the past two years. Other motivations are starting to play a bigger role in companies' plans, however. The proportion of companies pursuing cost synergies, as well as those seeking diversification and expansion of products and services was also up this year.

Looking ahead, the hunt for small deals continues to be the most popular M&A strategy on the corporate side, with 34 percent saying this tactic will drive decision-making (up from 26% from last year). Meanwhile, the biggest surge in strategy was among corporations seeking transformational deals. Whereas 17 percent of corporate respondents said they were on the lookout for such deals in 2014, that number has increased steadily over the past two years and represented 26 percent of respondents in this year's survey.

> "More firms this year are including M&A in their operating playbook. Aside from global economic concerns dampening organic growth plans, another reason M&A is rising to the forefront for corporates is the perception that valuations have stabilized and aren't receding any time soon. As a result, firms are looking to use M&A as a tool both for smaller, strategic, niche acquisitions as well as bold transformative deals."

—Jay Langan, partner, Deloitte & Touche LLP

For their part, private equity investors indicated they are holding portfolio companies for shorter periods of time. For the second straight year, the percentage of respondents who held their investments for five years or longer declined—the figure was more than 30 percent in 2014 while 23 percent indicated so in the most recent survey. This is consistent with the robust divestiture market we experienced in 2015.

"Recent shorter holding periods for PEIs demonstrates the continuing strength of the market."

—Andy Wilson, partner, Deloitte & Touche LLP

Terms and conditions—buyouts, multiples and financing

A significantly higher number of private equity investors (41 percent vs. 30 percent a year earlier) believe the debt market for leveraged buyouts will be tight or very tight. Half of private equity investors see leverage multiples of five or less. Further, more than 20 percent of these respondents said they expect multiples to be weaker in the coming year. That's a far less optimistic view than just a year ago, when only 14 percent of respondents expected multiples to decline.

After the record cycle of M&A transactions in 2015, corporations are favoring debt and equity issuance at the expense of cash in order to finance deals. For the second straight year, available cash as a funding source for corporate M&A deals was down, as less than half (47 percent) of respondents indicated, compared to 58 percent in 2014. Meanwhile, new equity issuance is up as nearly a quarter (24 percent) of respondents say it would be their primary vehicle to finance deals over the next year.

"Possible constraints in traditional debt markets will not limit transactions as PEIs have the wherewithal to access alternative sources of financing both domestic and international."

—Barry Curtis, partner, Deloitte & Touche LLP

Tight debt market for leveraged buyouts

41%

Up from 30% in 2015

Private equity investors

Deal environment pressures: economy, pricing and strategy

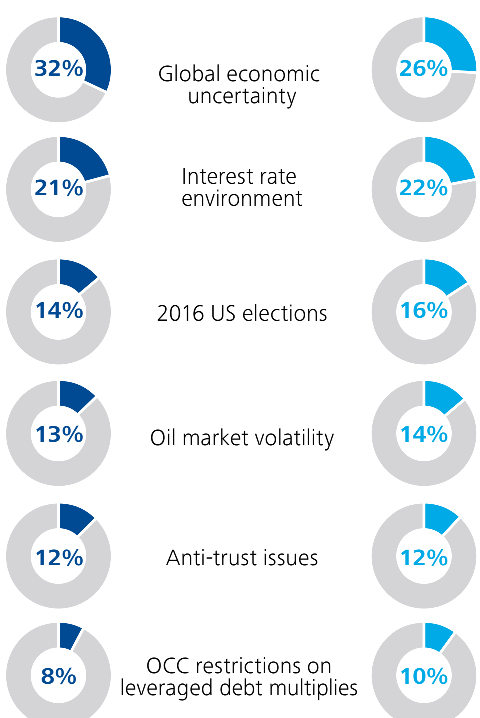
While low interest rates and easy access to debt have allowed many acquirers to orchestrate deals, the coming year may present some significant challenges for maintaining 2015's torrid pace. Continued economic uncertainty, particularly in Europe and in several markets across Asia, are expected to be a key concern for organizations as they hunt for deals. Global economic uncertainty ranked as the top influence on deal activity in the coming year among private equity investors. Meanwhile, both segments of respondents cited interest rates as the second most important factor, followed by uncertainty surrounding the 2016 US elections.

In our survey, both corporate respondents and private equity investors cited economic conditions as the top factor for deal success, a first since we began our survey in 2014. For corporations, 31 percent said market conditions were most critical to ensuring deal success, while 37 percent of private equity respondents cited the economy as the most important factor in successful transactions.

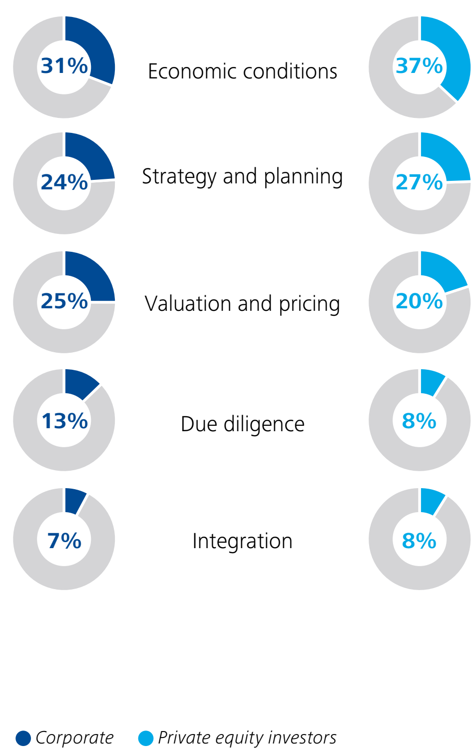
When looking at the top three factors leading to deal success in the aggregate, however, corporate respondents picked valuation and pricing as the top choice.

Despite global economic concerns, 75 percent of corporate respondents are still searching for a slightly larger share of cross-border deals. For private equity investors, 84 percent are seeking acquisitions in foreign markets.

Influence on pursuing, financing and closing deals



Top factors in ensuring deal success for your company



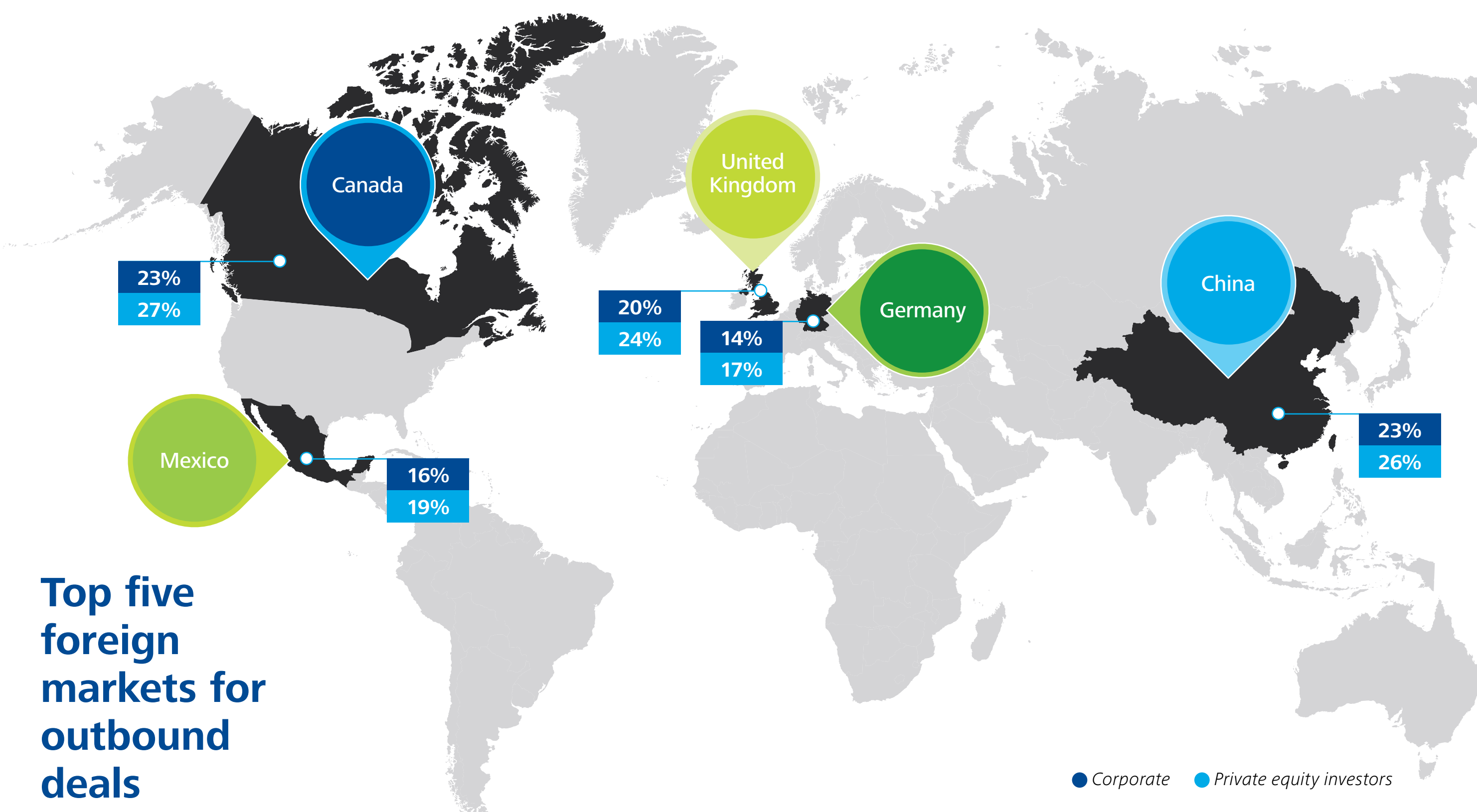
[9] http://www.wsj.com/articles/brazil-economic-woes-deepen-amid-political-crisis-1458946356

Interest in deals in the United Kingdom among corporate respondents is down for the second straight year, as 24 percent of respondents said they were likely to pursue UK deals, down from a high of 33 percent in 2014. Among private equity investors, intentions to pursue deals in France and Italy were down significantly from 2015, by margins of seven and six percentage points, respectively.

Only in Brazil, which has been in the throes of an economic and political crisis since 2014,[9] do both PEI and corporate respondents indicate they would be pursuing fewer deals, continuing a three-year trend of falling interest in that market (PEIs down from 24 percent in 2014 to 14 percent in 2016; corporates down from 23 percent to 12 percent).

"Europe is still experiencing slow growth and Brazil may be facing a severe recession. There's concern that the global market could impact the capital markets. At this stage, there's still a lot of uncertainty," said Barry Curtis. Nonetheless, liquidity among private equity investors means that deal pricing in destinations such as Brazil may become attractive later in the year or next if things stabilize there.

As compared to 2015, private equity investors also expressed about the same level of interest as last year in two significant Asian markets—China and Japan (one percentage point decrease each). Conversely, interest in pursuing transactions in Latin America gained five percentage points in Colombia and also rose slightly in Mexico, where respondents have indicated steady interest since we began our survey in 2014.



Top five foreign markets for outbound deals

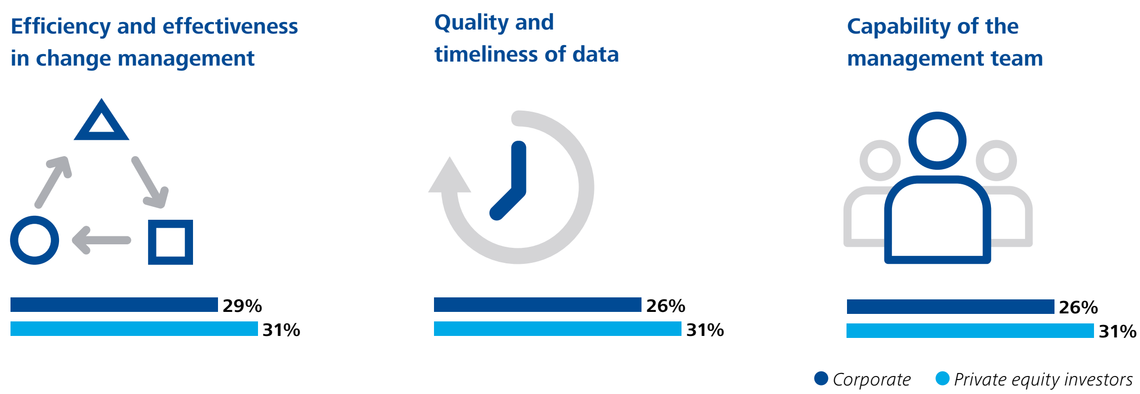
Getting execution, integration right

In this year's survey, there was a significant increase in respondents who said that the M&A transactions they had completed in the past two years had not met expectations. Thirty-nine percent of corporate respondents said that more than half of their transactions completed over the past two years had not generated expected returns, compared with 30 percent in 2015.

Private equity respondents also expressed growing concern about deals that had not met expectations over the last two years, with 56 percent of those surveyed saying more than half of deals had not returned expected value, up from 54 percent in 2015.

For both segments of respondents, gaps in execution and integration of deals comprised the key reason why deals did not generate the expected value (23% for corporates and 26% for PEI respondents). We also asked survey respondents for the first time this year to rank their top three concerns upon acquisition of a new target. Private equity respondents said the quality and timeliness of data was the top concern, followed by the capability of the management team, and efficiency and effectiveness in change management. On the corporate side, respondents ranked efficiency and effectiveness in change management as the top concern, followed by capability of management team, and quality and timeliness of data.

Top concerns upon acquisition of a new target

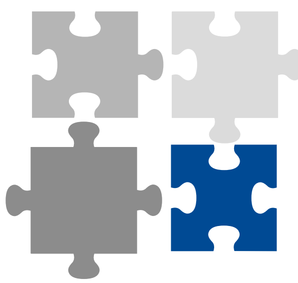


Building value through divestures

The share of corporations looking to shed assets that no longer fit into their business plans has been increasing steadily since we began our survey two years ago. While 31 percent of corporate respondents expected to pursue a divesture in 2014, the percentage climbed to 52 percent in this survey.

What's driving the pace of divestures, particularly for existing conglomerate firms, is a return to basics, said Andy Wilson, partner, Deloitte & Touche LLP. "When companies spin off or carve out a business they can achieve higher value for the remaining core business. Investing in a business that's easily understandable in the marketplace—that's what investors want. Additionally, you give the carved-out company a chance to flourish under a new owner," Wilson said.

The leading reason corporate respondents cited for divesting a business continues to be the release of non-core assets. More than 70 percent of corporate respondents ranked the existence of such assets as one of the top three factors in their decision to divest a business, a figure which has held steady since our first M&A survey in 2014. Market change (countering competitor tactics) also continues to be an important factor for corporate respondents—a quarter ranked it as the top driver of divestitures in this survey, while 79 percent mentioned changes in the market environment as one of the top three drivers of divestitures.



Corporate

Surge in divestitures

52% — Up from 39% in 2015

Private equity investors

Portfolio exits

68% — Up from 62% in 2015 — **Strategic sales**

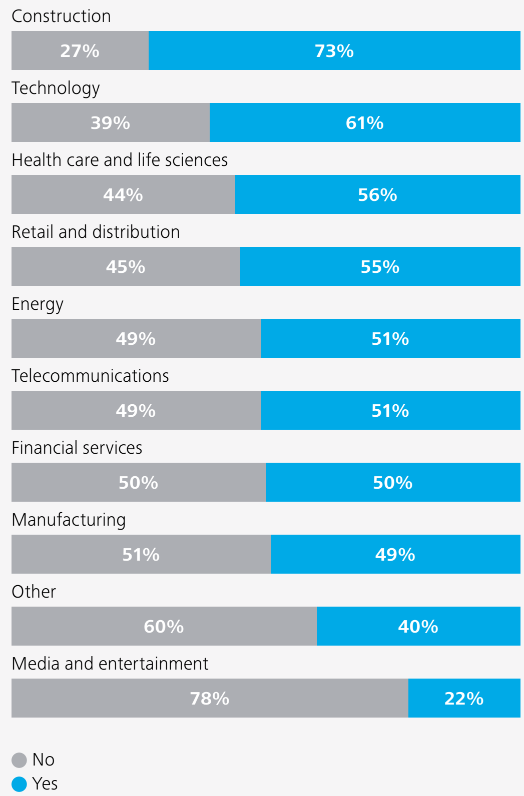
32% — Down from 38% in 2015 — **IPOs**

Life sciences was among the industries most likely to see divestitures, as 56 percent of respondents in 2016 said they would be pursuing a spin off in the upcoming year. A key motivator is the need to simplify portfolios, says Phil Pfrang, partner, Deloitte & Touche LLP. "There has been substantial acquisition activity within the life sciences industry. Any time they make an acquisition, it creates redundancies in their portfolios. Some of these companies become too complex for Wall Street to value them efficiently and a spin off or carve out can allow an asset within the portfolio to receive a higher valuation on its own. The sum of the parts is greater than the whole," Pfrang said.

For the second straight year, private equity investors also expect that portfolio exits will continue to increase. Three-quarters of private equity respondents (77 percent) anticipate that there will be additional exits this year—a slightly higher proportion than those in 2015 (74 percent)—and compared to 65 percent of respondents in 2014. Two-thirds of those exits will emerge in the form of strategic sales. And despite the slow IPO start to 2016, the remainder are expected to be IPOs, a trend that has largely remained steady since 2014.

We also asked respondents to evaluate what drives success in a divestiture. Although all categories were deemed important by respondents, an effective communication plan within the organization on future plans for the business for sale ranked highest in importance for both corporate (78 percent) and private equity investors (81 percent).

Divestitures by industry
Corporate respondents



"There has been substantial acquisition activity within the life sciences industry. Any time they make an acquisition, it creates redundancies in their portfolios. Some of these companies become too complex for Wall Street to value them efficiently and a spin off or carve out can allow an asset within the portfolio to receive a higher valuation on its own. The sum of the parts is greater than the whole."

—Phil Pfrang, partner, Deloitte & Touche LLP

M&A Analytics: Insights and challenges

Nearly a third (31 percent) of corporate respondents said analytics form a core part of their M&A strategy in our most recent survey, while 41 percent said they use technology in select areas of their analysis in these transactions. Adoption of analytics occurred at similar rates on the private equity side, with about three-quarters (74 percent) of respondents saying they use analytics and technology for at least part of their M&A analysis. These responses are slightly higher than those in our *Deloitte M&A focus on: Analytics* survey[10], a pulse survey fielded in December 2015. In that survey, 68 percent of corporate leaders reported using analytics in some area of their M&A activities, with 40 percent considering it a core component of their approach.

That survey also found that the most valuable stage of incorporating analytics in the M&A lifecycle was: strategy development (64 percent target screening (49 percent), integration (47 percent), due diligence (42 percent), transaction execution (40 percent), and divestiture (20 percent).

From that same pulse survey, our results showed that over the past year, 64 percent of companies increased the use of data analytics. And, over 80 percent of respondents indicated that analytics would play an important role in future M&A transactions.

Complexity continues to be the most common impediment for corporate respondents using analytics, while private equity investors also said those difficulties were the most likely reason why they hadn't used analytics in certain transactions.

Technology-driven data analytics

72%

Corporate

74%

Private equity investors

A majority of corporate and PEI respondents are deploying technology-driven data analytics as either a core component of M&A analysis or within select areas of M&A analysis.

[10] http://www2.deloitte.com/us/en/pages/mergers-and-acquisitions/articles/merger-analytics-survey.html)

Conclusion

After a record-breaking year for mergers and acquisitions across the globe, the outlook for M&A activity remains quite favorable. Numerous factors are converging—and promising to sustain if not accelerate the pace of M&A activity. Interest rates remain near historical lows and equity markets are stabilizing, which we expect will enable companies to access capital.

After a record-breaking year for mergers and acquisitions across the globe, the sentiment and outlook for M&A activity remains quite favorable. Numerous factors are converging—and promising to sustain a robust level of M&A activity. Interest rates remain near historical lows and equity markets are stabilizing. In increasing numbers, companies are venturing abroad for targets sensing bargains to be had—and opportunities to expand their global footprints. Meanwhile, corporate boards, shareholders, and regulators alike are exerting pressure on firms to divest units that aren't mission-critical, triggering strong interest in companies pursuing divestitures. Additionally, the ever-changing market is ripe for sector convergence with technology as well as consolidation within certain sectors.

Still, there are a number of potential obstacles that have emerged in this, our third annual, M&A Trends Report. The nearly 2,300 respondents—comprising corporate and private equity leaders—cited global economic uncertainty as a key concern. For the first time in our survey, economic concerns surpassed strategy, planning, valuation, and pricing as the top factor impacting deal success. Those concerns may have been reflected in the decline in M&A activity that companies observed during the first quarter.

"It remains to be seen whether this year will be a tale of two halves, with improvement after a softer start," said Russell Thomson, national managing partner, M&A Services, Deloitte & Touche LLP "We are seeing significant interest and enthusiasm across corporations and PE firms, yet the challenges are very real and global uncertainty could lead to slower M&A activity as compared to last year's record pace." He went on to say that, "While we can't control the economy, companies and PE firms can get the most out of their deals through focus, preparation, and execution. There's no substitute for a well-thought-out M&A strategy and a solid execution plan to improve prospects for the completion of a successful M&A deal."

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—Russell Thomson, national managing partner, M&A Services, Deloitte & Touche LLP

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