KPMG

M&A Outlook 2020

Deal insights for Northern Ireland and the Republic of Ireland

DEAL ADVISORY

Foreword

We are delighted to present the findings from our annual survey on the outlook for M&A activity in 2020. This survey was conducted with many leading corporate executives and M&A advisors in Northern Ireland (NI) and the Republic of Ireland (RoI). We hope that it provides valuable insights into M&A trends for the year ahead.

Russell Smyth
Partner, Deal Advisory

2019 – RESILIENT M&A MARKET

- The 2019 M&A environment was resilient across the island of Ireland.
- While NI deal volume increased from 2018, the bulk of transactions were at the smaller end of the spectrum, with no deal greater than £100m and total deal value significantly lower than previous years. The lack of larger deals may suggest more material strategic decisions were put on hold given global and domestic uncertainties.
- Strategic bolt-ons dominated the landscape amongst corporates across both jurisdictions with Kingspan, Greencore, Applegreen, Icon, Musgrave and IPL Plastics, and NI based Fane Valley and Henderson Group, all growing their customer base, expanding their product and service offering through acquisition.
- The predictions of last year's NI respondents largely rang true as the NI energy sector was very active and produced a high portion of the larger deals as investors such as Gore Street Energy Storage Fund, Equitix, Bio Capital, EPH, Resonance and ERG all invested here. Also as expected, the Agri Food and Drink sector remained active along with the TMT sector, where the exits of Tascomi and Novsco to global strategic players is indicative of the continued inbound interest in this sector.
- Private equity funds continued to feature prominently in both jurisdictions during the year. We have seen an increase in businesses releasing equity through minority disposals to private equity sponsors, demonstrating innovation in private equity deal structuring to deploy capital.
- Capital markets transactions are more sensitive to geopolitical uncertainty and remain subdued across the island of Ireland. This is also due to the presence of private funds capable of offering attractive valuations for divestments of scale. However, NI did add to the small population of listed entities through the IPO of Diaceutics.

2020 – STEADY IN UNCERTAIN TIMES

- Following a turbulent 2019, 2020 has started with the prospect of relative stability - a return of the devolved institutions, a stable Conservative majority in Westminster and clarity that Brexit is at least going to happen.
- That said, US trade policy, exchange rate fluctuations and the uncertain implications of Brexit will ensure strategists and corporate deal makers won't have an easy time.
- The scale of available capital in the market has undoubtedly contributed to survey respondents' (both north and south) optimism for the year ahead. Private equity dry powder and the robust lending market, with ever developing debt options, will be key enablers for deals in 2020.
- We expect sector convergence to continue, with Technology, Financial Services and Energy / Utilities the main arenas to watch, again common themes across the island of Ireland.
- We anticipate that RoI corporates will continue to cast their nets wide geographically, and also into new verticals / channels. NI corporates are likely to stay closer to home, with increased North-South activity as observed in 2019. We also expect M&A to be increasingly used as a mechanism to de-risk uncertainty and pivot business models, particularly with Brexit in mind.
- In 2019, climate change emerged as a dominant global issue. As a consequence, changing investor and consumer attitudes towards sustainability will be key factors for executive decision making in 2020.

Finally, we would like to thank all those who took the time to complete the survey and inform our analysis.

Highlights

M&A STRATEGY

Surprisingly few respondents have well-developed M&A communication strategies and / or documented approaches. A proactive M&A strategy can unearth synergies and innovative structures.

CLIMATE CHANGE

Climate change has become one of the dominant global mega trends featuring centrally on the leadership agenda, with 67% of respondents believing it will form a component of 2020 M&A strategies.

DEAL FAILURE

Valuation gaps continue to be considered the primary inhibitor of M&A activity while an increasing proportion of respondents cited **unexpected diligence issues** as a factor likely to put deals at risk in the year ahead.

BREXIT

At the date of our survey, participants resoundingly considered **certainty in the context of an outcome** as the key facilitator for deal activity in 2020. Whilst it's now clear that the UK **will be leaving the EU on 31 January 2020,** the key issue is whether a new **Free Trade Agreement** will be agreed **before the transition period ends on 31 December 2020.**

DEBT FUNDING

The majority of **M&A transactions are expected to be funded by senior debt / cash flow facilities** in 2020.

WORKING CAPITAL

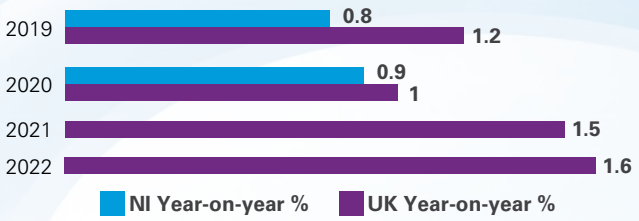
Many respondents have encountered **sub-optimal working capital management** when evaluating targets, often leading to opportunities to **extract cash** post acquisition.

Economic context

In the backdrop of an uncertain trade and political climate, Northern Ireland's economy has grown modestly in recent years. The return of Stormont, a more expenditure-focused fiscal policy and new investment plan for NI can support growth.

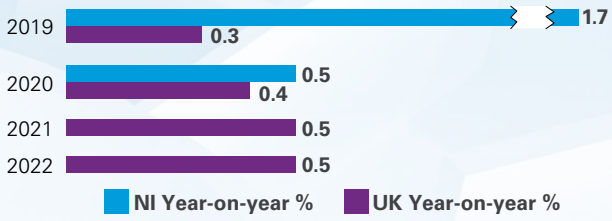
ECONOMIC OUTPUT

Northern Ireland's economic output is estimated to have grown by 0.8% in 2019. Key drivers of growth were the construction, public, and services sectors. Similar growth is forecasted in 2020. Most major bodies are forecasting modest growth across the UK into 2022, fuelled by Brexit uncertainty and global trade concerns.



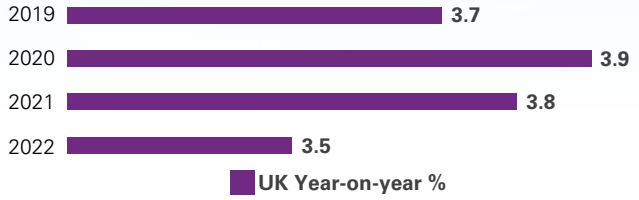
EMPLOYMENT GROWTH

At November 2019, employment in NI reached 881,000. Similar to the UK-wide picture, this represents an all-time high, with NI up 2.7% on November 2018. Growth was strong in the private and services sectors. GB employment reached almost 32 million at Q3 2019, and forecasters are projecting continued modest growth over the coming years, due in part to capacity constraints.



EXPORTS

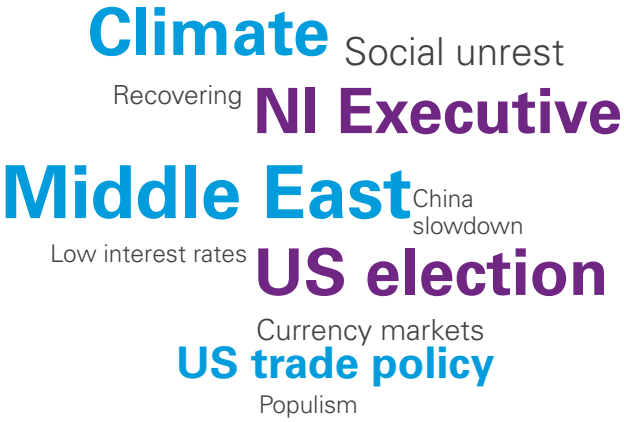
External sales from NI reached ~£22 billion in 2018 (latest available). Inter-UK trade declined (-9%), while trade with RoI (+9%) and the rest of the EU increased (+21%). Ambiguities in NI's post-Brexit trade position may be encouraging firms to seek opportunities beyond NI's borders.



INFLATION

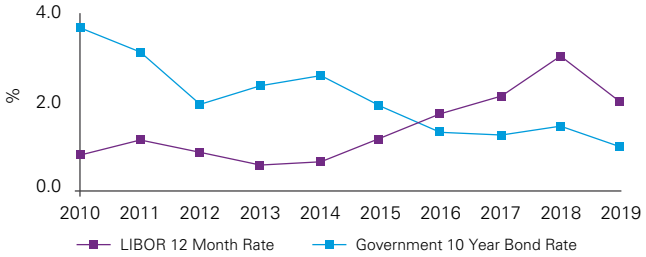
UK inflation was 1.4% in the 12 months to December 2019, a three-year low, said to be driven by a weak sterling and a low growth rate. The forecast is for higher inflation into 2022, close to the Bank of England's target rate of 2.0%.

GLOBAL MACRO CONTEXT



COST OF DEBT LOOKBACK

UK Government bond yields fell as the UK economy weathered the financial crisis from 2008, falling from an average of 3.6% in 2010 to an average of 1.0% in 2019, a 60 year low. The LIBOR rate – the rate UK banks borrow at – increased over the same period, from 0.8% in 2010 to 2.0% in 2019, as banks were increasingly required to hold more capital.

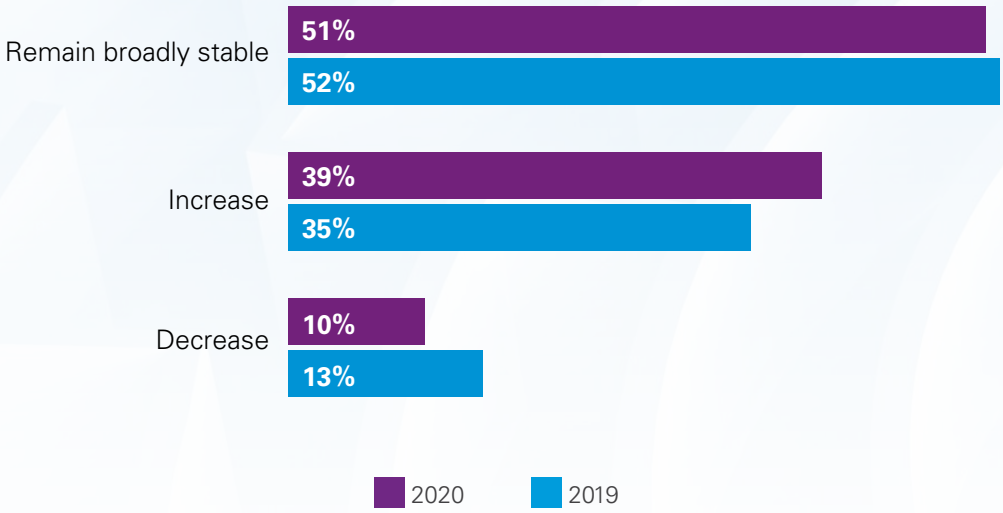


Notes: Economic Output (NI) refers to Danske Bank estimate for output in 2019 and 2020. Economic output (UK) for 2021 and 2022 sourced from UK Office for Budget Responsibility (OBR). Employment growth refers to seasonally adjusted employment, an agreed metric. Exports from NI refers to sales outside NI and GB in 2018 – 2019 data will be first available in late 2020. No export forecasts available for NI. Inflation refers to CPI inflation rates. No estimate available for NI, UK rate sourced from the Office of National Statistics (ONS) for 2021 and 2022.

Sources: Danske Bank Quarterly Sectoral Forecasts 2019 Q4; OBR Labour Market forecast; Northern Ireland Statistics and Research Agency (NISRA) Broad Economy Sales and Exports Statistics 2018; Office of National Statistics Consumer Price Index; LIBOR rate – sourced from macrotrends.net, a financial website (January 2020); UK 10-year bond rate – sourced from Federal Reserve Economic Data (December 2019).

Deal Volume

How do you expect deal volume in Ireland, north and south, in 2020 will compare to 2019?



Deal makers have grown accustomed in recent years to trading in an environment complicated by geopolitical uncertainty. Participants' optimism clearly has not dampened in the face of these macro headwinds, as 90% expect 2020 deal volumes to remain at or above the healthy levels of 2019.

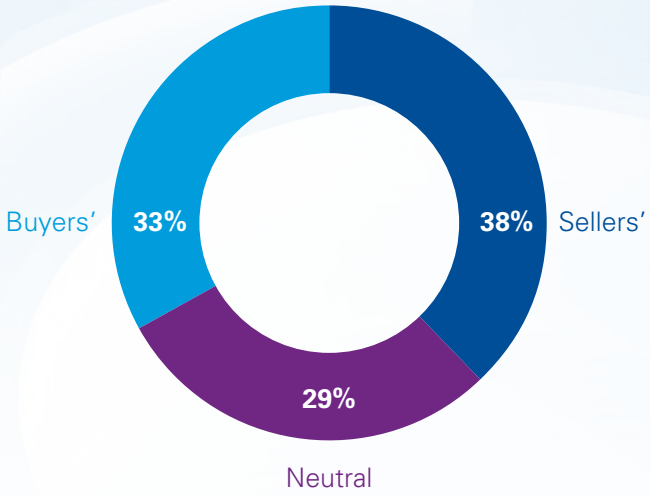
Respondents anticipate that deal making fundamentals intrinsic to the current landscape will remain unchanged in 2020. The quality of assets, low interest rates and competition among financial and strategic players will allow M&A executives to work through the uncertainty and continue executing M&A strategies in the year ahead.

" In addition to our financial capacity, we find our balanced and transparent approach to dealing with vendors and our proven track record of consistently executing acquisitions to be key factors in successful deal completion."

MANDY O'SULLIVAN
Head of Corporate Finance
DCC plc

2020 market

Will 2020 be a buyers' or a sellers' market?



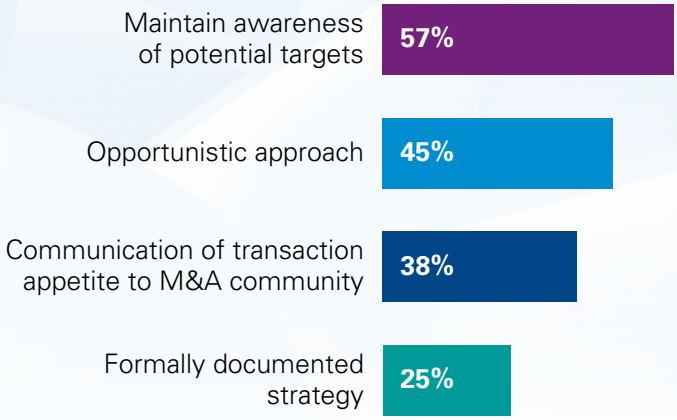
In our 2019 outlook, 60% of respondents believed that the market was in the sellers' favour. Our 2020 survey records a shift where respondents believe the market is more balanced. The change in perception may signal a reduction in market confidence driven by prevailing macro-economic factors.

From buyers' perspectives, Ireland (north and south) is a hub of profitable and innovative targets and an attractive home for investment. There continues to be steady competition for Irish assets amongst well-funded domestic and international investors.

Interestingly, NI respondents held quite a different view to RoI, with only 17% expecting 2020 to be a sellers' market.

M&A strategy

What is your approach to M&A strategy?



Note: Results represent the percentage of positive responses per category.

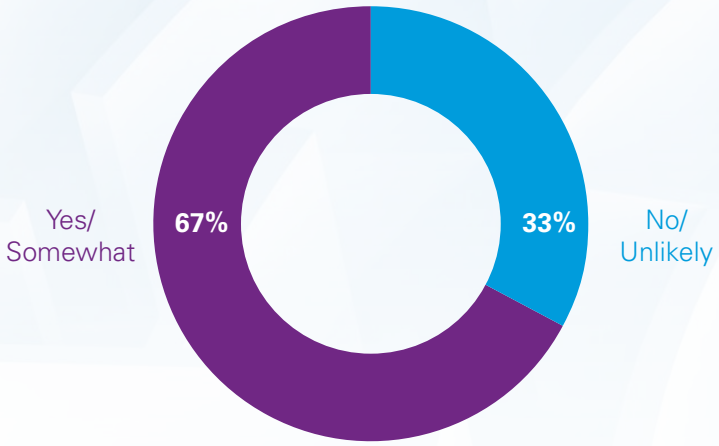
Predictably, participants take a multi-faceted approach to their M&A strategy. However, it is noteworthy that few have well-developed M&A communication approaches and / or formally documented programmes.

The development of a formal multi-year M&A strategy can bring rigour to the investment process. It focuses the boardroom on priority objectives, whether to buy, build, sell or hold, and how best to execute. This discipline encourages the early identification of targets and development of specific knowledge, to inform the optimum timing and pricing of target approaches.

A proactive approach to M&A strategy is one that can unearth synergies and innovative structures that may go untapped if left to opportunism. Communication with the M&A community can augment this approach, facilitating the introduction of opportunities and development of relationships with targets early in the deal cycle.

Climate change

Will the growing requirement for society and businesses to address the climate change and decarbonisation agenda be a consideration in M&A strategy for 2020?



This is the first year that the survey has considered the issue of climate change and decarbonisation and it is telling that 67% of respondents believe that this will form a component of M&A strategies in 2020.

Climate change and decarbonisation has become one of the dominant global mega trends featuring centrally on the leadership agenda. Changes in consumer and investor attitudes towards supply chain sustainability, increased regulatory focus and the trajectory of carbon tax rates will be key executive considerations for the year ahead.

This is certainly a space to watch and track how corporates and funders, in both jurisdictions, alike respond to this challenge.

" We are not surprised to see climate change evolving as a key acquisition consideration for the deal making community. From a growth perspective, we are committed to reducing the reliance of our business on carbon-based products to a point that in H1 2019 c.75% of gross profit was derived from non-fuel revenue streams."

RONAN RYAN
Group Head of Acquisitions
Applegreen plc

RUSSELL SMYTH
Partner, Head of Sustainable Futures
KPMG in Ireland

KPMG Insight

We predict 2020 will be the year where climate change moves from being an important social consideration to being a key policy and commercial driver.

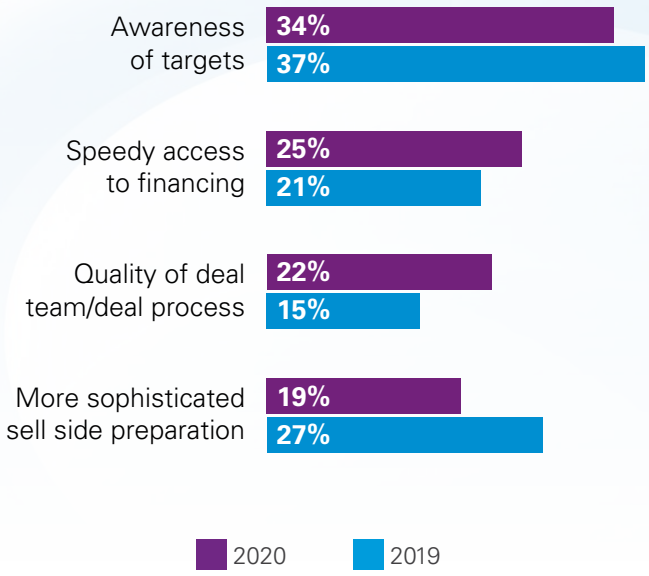
Climate change has increasing prominence at domestic, European and international level. ECB President Christine Lagarde has promised to put climate change at the heart of the bank's agenda, in a move designed to direct capital flow towards green investments and away from carbon intensive industries, while EC President, Ursula von der Leyen, has announced the 'European Green Deal', which aims to have Europe the first Net Zero continent by 2050.

Locally 2019 saw the Irish Government publish an ambitious Climate Action Plan which seeks to put Ireland on a path to net zero carbon emissions by 2050, with new renewable support schemes due in 2020.

In stark contrast, Northern Ireland remains without an energy policy, decarbonisation strategy or any renewable support schemes. With the aftermath of RHI still lingering, there remains considerable risk this policy gulf between the two jurisdictions only widens over the coming year.

Deal making

What factors will enable greater deal making in Ireland (north and south) in 2020?

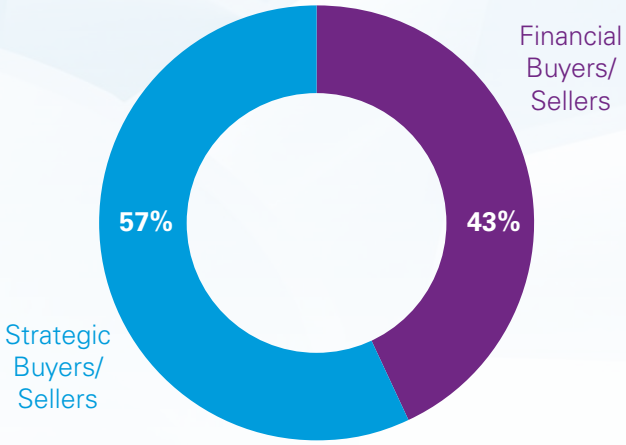


In a continuing trend from previous surveys, participants believe that target identification will be the cornerstone on which Irish M&A strategies are built. A strong pipeline allows M&A executives take a discerning view when screening potential targets, thereby increasing the likelihood that key investment criteria are met. The quality of a deal maker's network will go some way in determining whether suitable targets are brought to their attention at an early stage of a deal cycle.

While the current low interest rate environment is undoubtedly an enabler for deal making, the time frame in which funds can be accessed is also critical for respondents. A well-prepared borrower with access to key funding stakeholders will avoid losing transaction momentum which could otherwise threaten to derail a process.

Buyer types

Which group would you consider most likely to complete the highest volume of transactions across the island of Ireland in 2020?



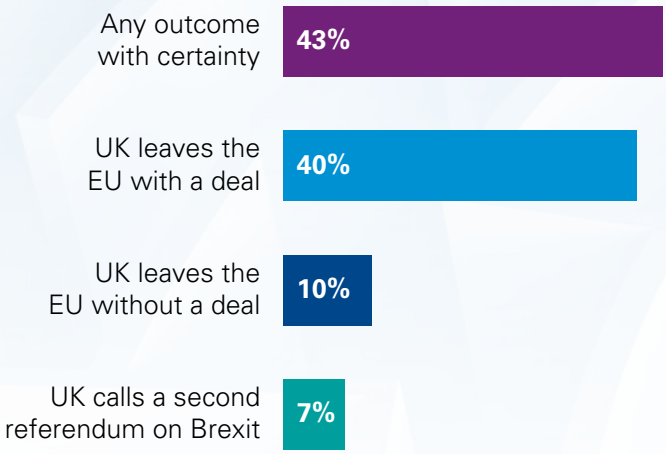
Those surveyed expect trade players, availing of attractive lending terms and an ability to realise synergies, to have the edge over financial buyers when competing for Irish assets in 2020.

Nevertheless, there appears to be no end in sight for the rise of private equity in both jurisdictions, as funds sit on substantial dry powder. We expect to see financial players featuring prominently on both sides of deals in the year to come as portfolios mature and exit strategies are executed.

Financial sponsors are also providing attractive alternatives for businesses which otherwise may have sought an IPO. Executives that value the speed, control and cost (to execute) of a private divestment could have their heads turned by the institutionally backed, international funds capable of offering valuations to rival the public markets.

Brexit

Which of the following Brexit outcomes would facilitate greater deal activity involving companies in NI and RoI in 2020?



Following the protracted and unpredictable Brexit negotiations to date, it is no surprise that respondents resoundingly consider certainty as the key facilitator for deal activity in the year to come.

A less volatile geopolitical landscape would allow deal makers to anchor decisions in more stable foundations, while certainty would also take the leash off those adopting a wait-and-see approach, adding further liquidity to the market.

JOHNNY HANNA
Partner in Charge and Head of Tax
KPMG in Northern Ireland

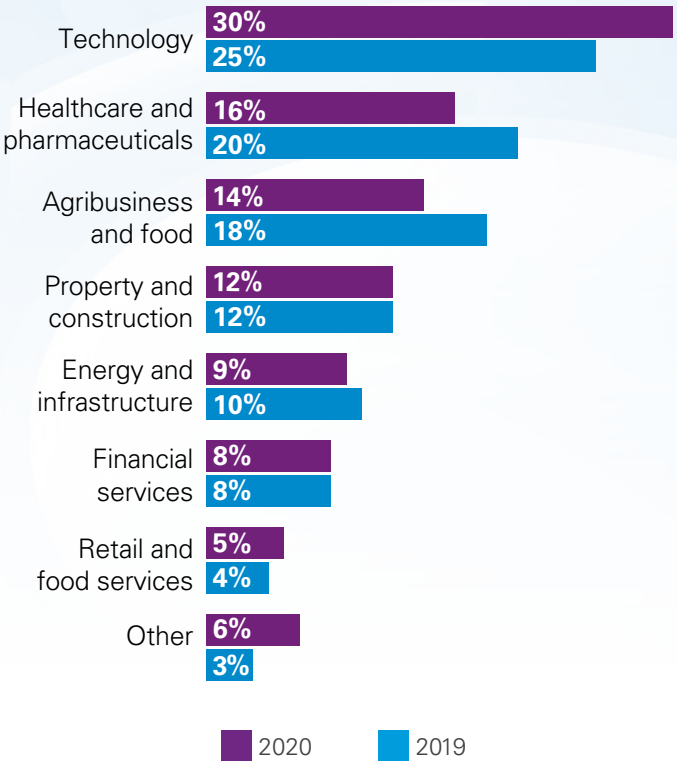
KPMG Insight

Whilst it's now clear the UK will be leaving the EU on 31 January 2020 with a transition period to the end of 2020, don't be surprised if deal makers are still citing Brexit related uncertainty through 2020. The key issue in 2020 is whether a new Free Trade Agreement (FTA) will be agreed before transition ends. Getting clarity on the future trading terms between the EU and UK will be significant for many businesses who trade heavily with GB.

It will also affect the value of GB based businesses that trade heavily with the EU. Whilst important details are yet to be worked out for Northern Ireland businesses who trade heavily with GB, it is helpful to know that regardless of whether a EU/UK FTA is agreed, goods can move freely across the NI/RoI border with no tariffs, duties or paperwork.

Sector activity

Within which sectors would you anticipate the most acquisitions to occur in Ireland, north and south, in 2020?



For the third consecutive year, respondents believe that Technology, Healthcare & Pharma and Food & Agribusiness will be the most active sectors for acquisitions.

Participants anticipate that the level of activity in the Technology sector will continue to grow. The Technology sector has enjoyed steady deal flow in recent years with enduring appetite for Irish tech-enabled assets.

Meanwhile, the increasing clarity around Brexit is expected to serve as a stimulant in the Food and Agribusiness sector. Two years of uncertainty has had a considerable effect in this arena.

While NI and RoI respondents held fairly common views on sector activity, Healthcare and Financial Services activity were ranked considerably lower in NI, replaced by Energy and Agribusiness as the more likely activity sectors.

CHRIS DONNELLY
Director, Deal Advisory
KPMG in Northern Ireland

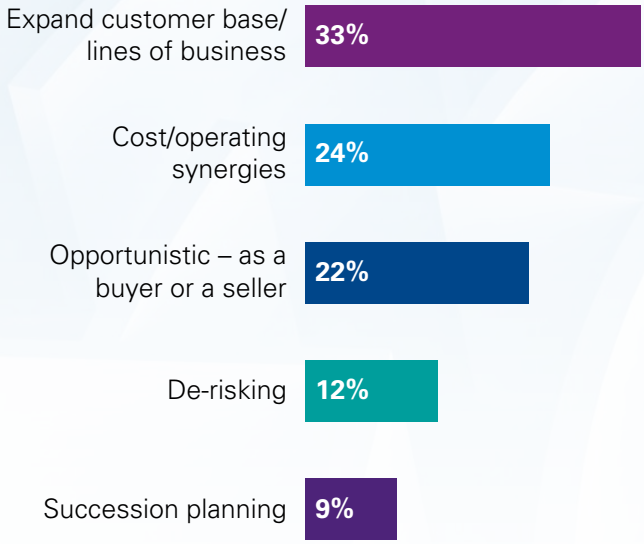
KPMG Insight

Northern Ireland has historically produced some extremely high-quality tech businesses that have attracted the attention of strategic buyers globally. The volume of these high calibre companies is increasing, due to a vibrant tech community and increasingly supportive eco-system, which should ensure Tech M&A remains strong in 2020. Factors underpinning this trend include transitioning to the cloud, software-as-a-service becoming important in all industries, large corporates seeking to future-proof business models, as well as the increasing value of data and analytics. NI has developed some high value clusters, most notably in Cybersecurity, but also in Telco, FinTech, HealthTech, Big Data and AI, and we would expect these sub sectors to drive transaction activity.

The Agri-Food sector plays an important role in the local economy and Northern Ireland continues to produce long established market leaders and new innovative companies in this area. The drivers for further investment and sector consolidation remain strong. While there were some important transactions completed in 2019, indications are that that 2020 will be a more active year, particularly if there is greater certainty around Brexit.

Deal drivers

What will be the primary shareholder considerations / drivers for transactions in 2020?



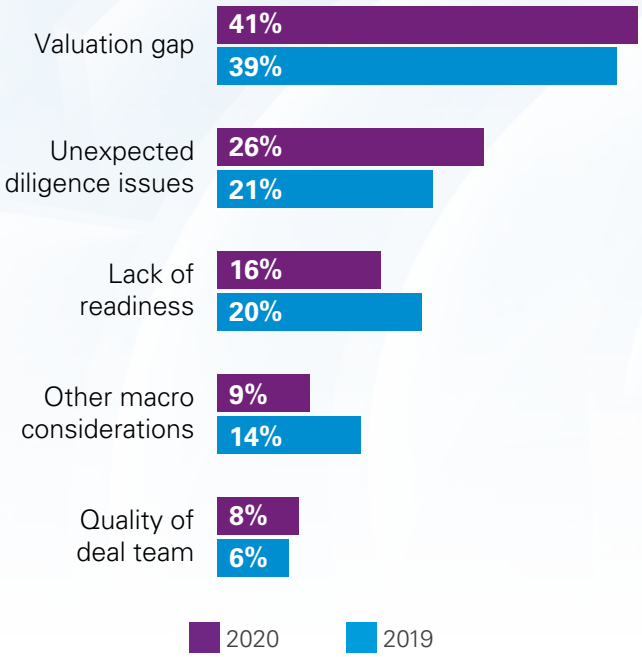
Commercial objectives, to either expand or create synergies, are the primary imperatives expected to stimulate deal making in 2020.

Buyers seeking to execute an inorganic growth strategy will focus on a target's customer base, service offerings, channels and geography during due diligence. Understanding the margin characteristics of these revenue drivers is key to identifying the intrinsic value of a target's activities.

Respondents expect that an opportunistic approach will continue to play a role in deal making, as buyers and sellers alike are keen to seize opportunities when the right value proposition arises.

Deal failure

In your opinion, what are the primary reasons for deal failure?



Valuation gaps continue to be considered the primary inhibitor of M&A activity in Ireland.

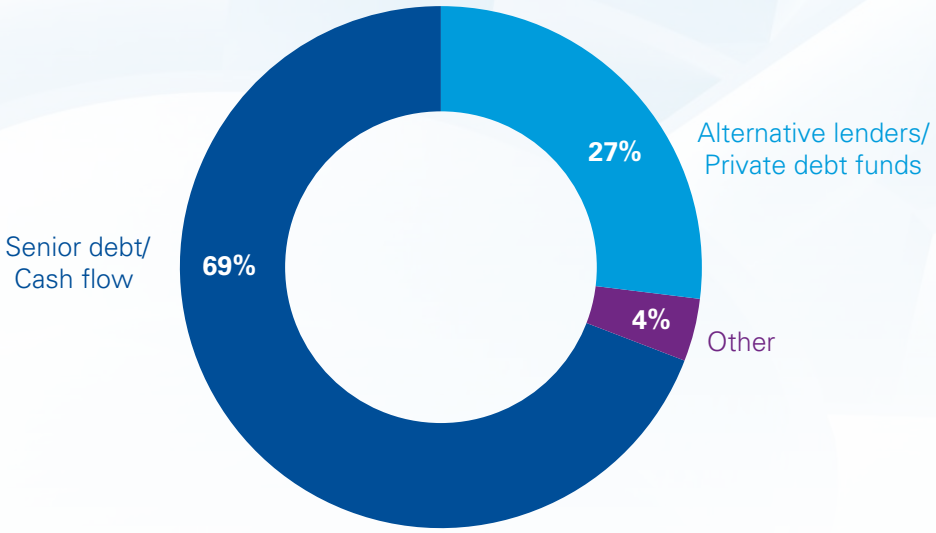
In our experience, where valuation gaps initially appeared fatal, we have seen more nuanced and balanced approaches to deal structuring keeping processes alive.

Earn-outs or minority divestments allow vendors to prove their growth story and benefit from the value not demonstrated at the initial offer stage. Notwithstanding, if either party is materially overplaying its hand and valuation is not grounded in market realities, the gap is not likely to be bridged.

Many respondents predict that unexpected diligence findings or lack of readiness will also be drivers of deal failure. From a seller's perspective, the importance of deal readiness cannot be overstated. Where potential deal-breaking issues are not addressed at the outset of a process, our respondents' prediction will continue to become reality.

Debt funding

When considering debt funding in 2020, what is likely to be the primary source of debt?



Perhaps unsurprisingly, the majority of respondents intend to use senior debt and cash flow facilities as the primary source of transaction funding in 2020. The traditional banks continue to play a very relevant role in a functioning Irish M&A funding market, with attractive terms and credit availability facilitating and stimulating deal activity across a variety of structures.

In recent years, the competition and influx of debt capital from private debt funds has brought innovation in the debt markets, with flexible debt instruments available across the capital stack. It is interesting to note that many respondents expect to make use of these options in 2020.

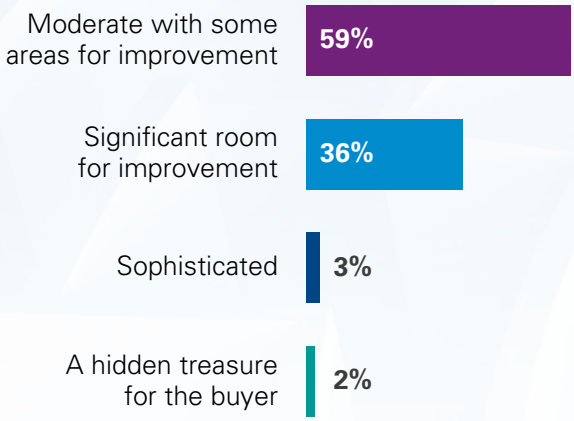
With the ever-developing banking market, corporates are actively examining the optimum blend of debt facilities and focusing on tailoring their debt packages. Requirements range from maximising leverage to ensuring sufficient capacity for seasonal cash flow variances, and corporates are routinely combining debt options to focus on flexibility, tenor and pricing.

" Appetite to provide significant M&A funding in the Irish market remains strong. We support our customers with a full suite of M&A funding options, including acquisition finance, mezzanine debt and equity financing. Irish companies have shown great ambition and professionalism in executing strategic acquisitions, both domestic and cross border, and we look forward to continuing to fund this activity"

CATHY BRYCE
Managing Director, Corporate and Institutional Banking
AIB plc

Working capital

When you have evaluated target companies in the past, how would you judge their approach to managing working capital both operationally and in a deal context?



Many respondents have encountered sub-optimal approaches to working capital management when evaluating targets in the past.

From a buyer's perspective, working capital inefficiencies can represent an opportunity to release cash from a target business post acquisition. These inefficiencies may also serve as a warning during diligence when assessing the capability of a target's finance function.

On the other hand, vendors taking a focused approach to working capital management protect their intrinsic value in a transaction context and importantly enhance their net cash position on a business as usual basis.

NEIL O'HARE
Partner, Deal Advisory
KPMG in Northern Ireland

KPMG Insight

Understandably, business planning tends to focus on key drivers of growth such as revenue metrics, product pipelines, customer relationships and associated cost and margin impacts. Just as important however, is a deep understanding of working capital dynamics to ensure funding capacity to support growth ambitions and to minimise the level of cash trapped in this feature of a business. Preparing monthly rolling forecasts can assist with identifying any potential funding pinch points and should provide impetus to take alternative management actions or seek additional funding if necessary.

Often cash flow can be enhanced by aligning existing working capital metrics to sector benchmarks. Effective techniques include improved cash collection, extension of creditors or faster stock turnover. Given the benefits of focused working capital management, a detailed understanding of the inherent characteristics can present a value opportunity for well informed and prepared parties to a transaction, whether vendors or prospective purchasers.

Methodology

M&A Outlook 2020 is based on research conducted in December 2019 amongst a wide cross section of Ireland's leading M&A executives and advisors:

- Indigenous private Irish: 28%
- Corporate finance, legal and other advisors: 25%
- Irish PLCs: 25%
- Private equity: 15%
- Multinational companies in Irish markets: 7%

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