KPMG

M&A Outlook 2020

Deal insights for Ireland

DEAL ADVISORY

Foreword

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

Mark Collins
Partner, Head of Deal Advisory

David O'Kelly
Partner, Corporate Finance

2019 – RESILIENT M&A MARKET

- The 2019 M&A environment was resilient despite various uncertainties and macro headwinds. Disruption is now considered a norm and the investor community does not stand still.
- Strong deal flow was sustained by continued inbound interest in high quality Irish assets, together with access to funding at attractive terms and healthy competition between strategic and financial buyers.
- Strategic bolt-ons dominated the landscape amongst Irish corporates with Kingspan, Greencore, Applegreen, Icon, Musgrave and IPL Plastics all growing their customer base / expanding their product / service offering through acquisition.
- Carlyle Cardinal's exit from Payzone (to AIB / First Data) and MML's acquisition of RelateCare ensured that indigenous private equity funds also featured prominently.
- During the year we have also seen a number of Irish businesses releasing equity through minority disposals to private equity sponsors, demonstrating innovation in deal structuring to deploy capital.
- Capital markets transactions are more sensitive to geopolitical uncertainty and remain subdued. This is also due to the presence of private funds capable of offering attractive valuations for divestments of scale.
- Another clear emerging trend is investor appetite for technologies and capabilities to support a long-term view of value creation.

2020 – STEADY IN UNCERTAIN TIMES

- At the outset of 2020, the deal making fundamentals of the Irish market remain strong, notwithstanding the endemic turmoil in the geopolitical landscape.
- US trade policy, the US election, Brexit and the potential of conflict in Iran are all threats to market confidence as we go to print. Deal makers will also be mindful of the evolving domestic political landscape as we approach our own general election on 8 February.
- The scale of available capital in the market has undoubtedly contributed to survey respondents' 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.
- We anticipate that Irish corporates will continue to cast their nets wide geographically, and also into new verticals / channels. We also expect M&A to be increasingly used as a mechanism to de-risk uncertainty and pivot business models.
- 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 Irish 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

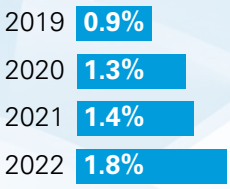
Most headline economic indicators suggest that Ireland's economy is performing strongly which bodes well for continued prosperity into 2020. While the Irish outlook is broadly sanguine, there are dynamics at play contributing to significant levels of global economic uncertainty.

GDP

As of early 2020, Ireland's GDP is greater than €345 billion and has been growing at the fastest rate in Europe for over five years.

INFLATION

Inflation has been low for several years, due to cost control during the recovery and more recently, Brexit.

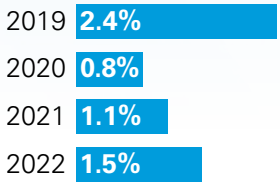


EXPORTS

Buoyed by pharmaceutical output, monthly goods exported were never greater (€14 billion) than in October 2019 (last available). Forecast growth for 2020 is moderate due to Brexit caution. It is projected to increase thereafter assuming a trade agreement is reached.

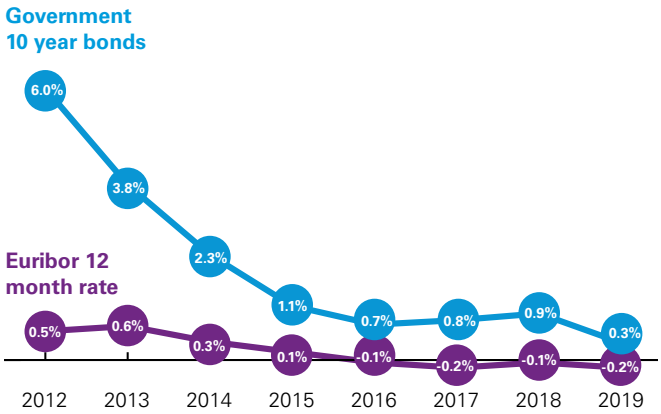
EMPLOYMENT GROWTH

Unemployment has fallen below 2007 levels, while employment reached an all-time high of more than 2.3 million in Q3 2019. Continued growth is projected, although capacity is being reached.



GLOBAL MACRO CONTEXT

COST OF DEBT LOOKBACK

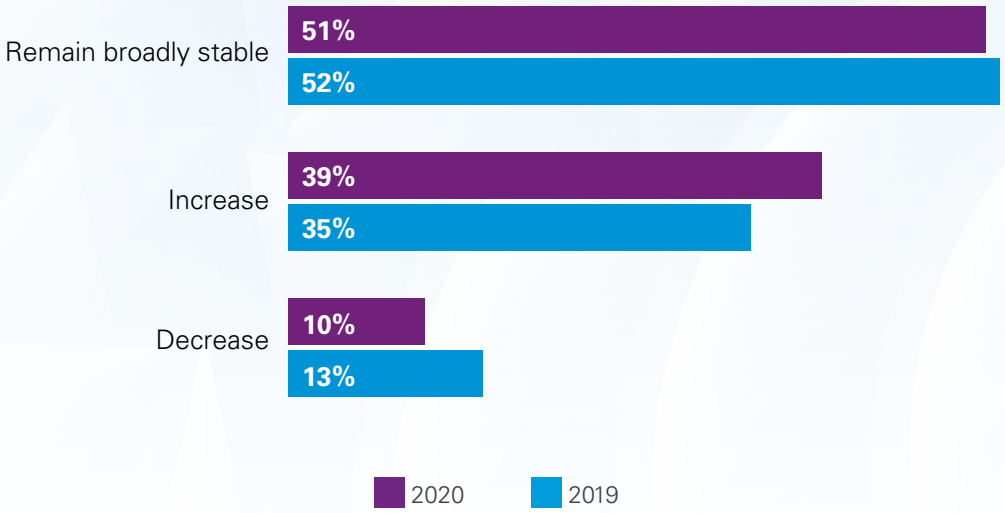


Notes: GDP refers to real GDP (exclusive of inflation). Inflation refers to the Harmonised Index of Consumer Prices (HICP). Unemployment refers to Seasonally Adjusted Unemployment (aged 15-74) at December each year. EURIBOR – Euro Interbank Offered Rate, the rate European banks borrow at.

Sources: GDP forecasts – Department of Finance (January 2020); Inflation – Department of Finance (November 2019); Employment – Central Statistics Office (CSO) – Labour Force Survey; Exports – CSO Goods Exports and Imports (October 2019); EURIBOR rate – sourced from euribor-rates.eu, a financial website (January 2020); Irish 10-year bond rate – Federal Reserve Economic Data (December 2019).

Deal Volume

How do you expect deal volume in Ireland 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.

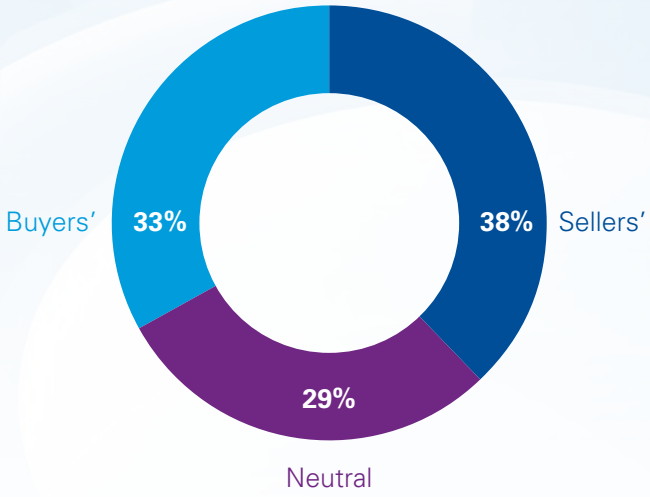
Respondents anticipate that deal making fundamentals intrinsic to the current Irish landscape will remain unchanged in 2020. The quality of assets, low interest rates and competition among financial and strategic players will allow M&A executives to work through the uncertainty and continue executing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

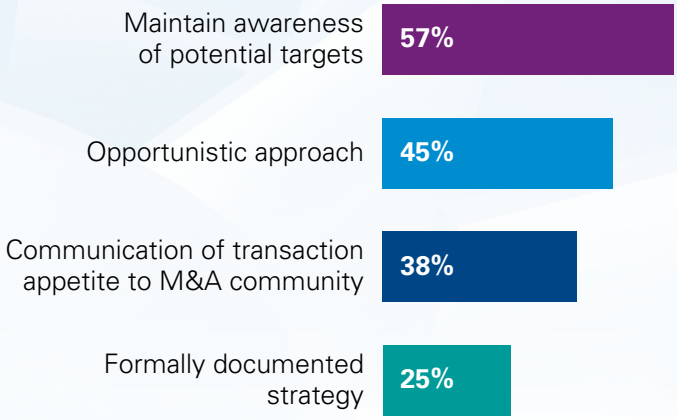


In our 2019 outlook, 60% of respondents believed that the market was in the sellers' favour. Our 2020 survey records a shift where respondents believe the market is more balanced. The change in perception may signal a reduction in market confidence driven by prevailing macro-economic factors.

From buyers' perspectives, Ireland 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.

M&A strategy

What is your approach to M&A strategy?



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

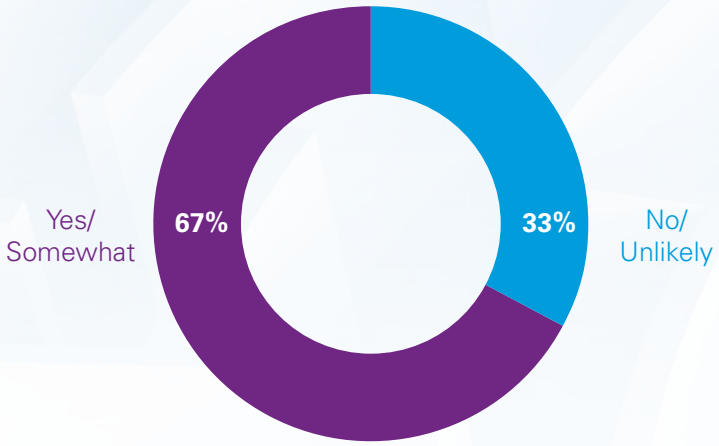
Predictably, participants take a multi-faceted approach to their M&A strategy. However, it is noteworthy that few have well-developed M&A communication approaches and / or formally documented programmes.

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 Irish corporates and funders 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

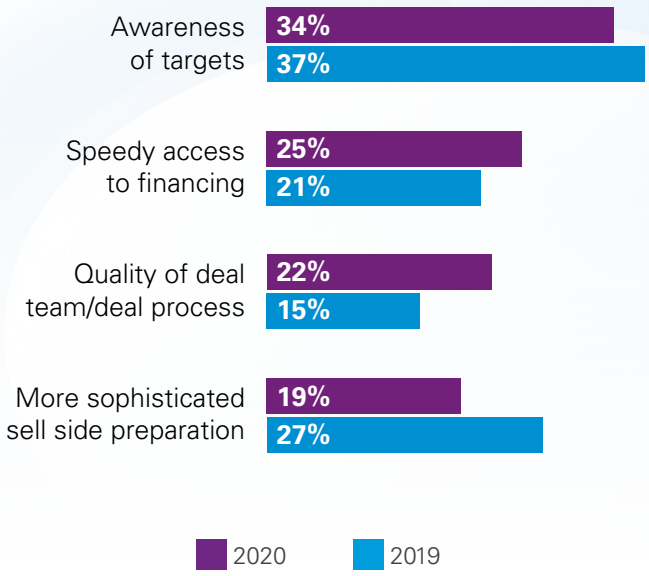
KPMG Insight

2019 has seen the Irish Government publish an ambitious Climate Action Plan which seeks to put Ireland on a path to net zero carbon emissions by 2050. The issue of climate change also has increasing prominence at a European and International level, with new ECB president Christine Lagarde promising to put climate change on the bank's agenda, in a move designed to direct capital flow towards green investments and away from carbon intensive industries.

2019 also saw public protests in Dublin and other cities across the world against the perceived slow response by policy-makers. The private sector is responding, with many companies moving to decarbonise their operations and challenge their suppliers to do likewise. It is unsurprising therefore, that the majority of respondents believe that decarbonisation and the broader sustainability agenda will influence M&A strategy in 2020.

Deal making

What factors will enable greater deal making in Ireland in 2020?

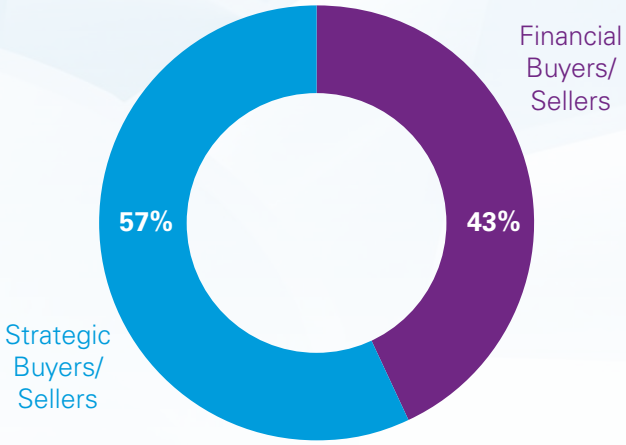


In a continuing trend from previous surveys, participants believe that target identification will be the cornerstone on which Irish M&A strategies are built. A strong pipeline allows M&A executives take a discerning view when screening potential targets, thereby increasing the likelihood that key investment 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 in Ireland in 2020?



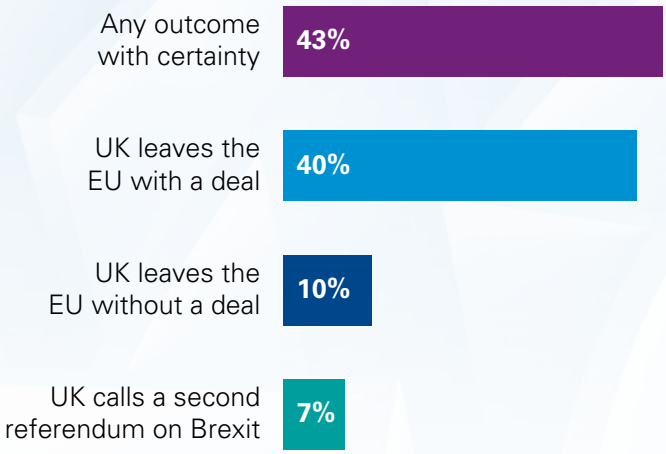
Those surveyed expect trade players, availing of attractive lending terms and an ability to realise synergies, to have the edge over financial buyers when competing for Irish assets in 2020.

Nevertheless, there appears to be no end in sight for the rise of private equity in the Irish market, 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 Irish companies 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.

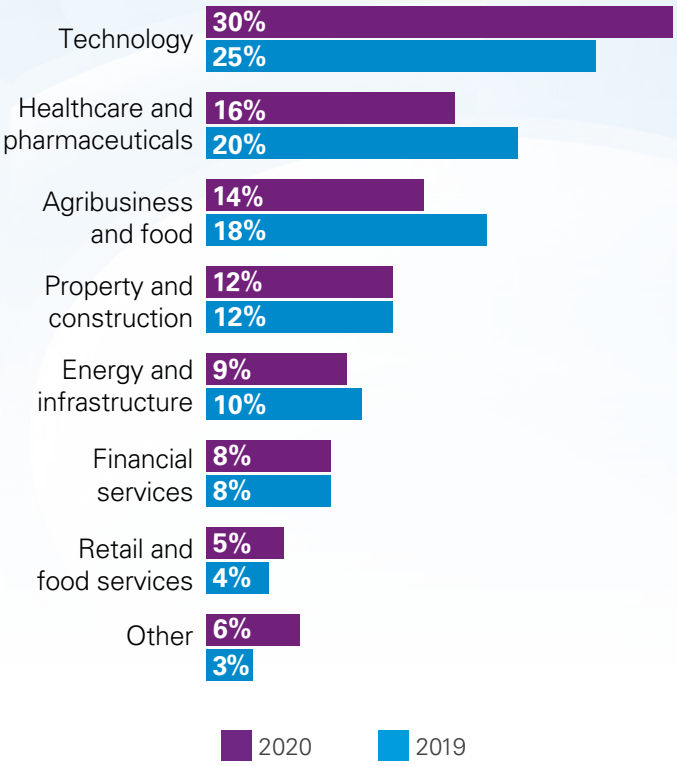
BRIAN DALY
Partner, Head of Brexit Response Team
KPMG in Ireland

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. Until this is clear and what the terms of that deal are, the threat of a cliff edge, with trade defaulting to tariff laden WTO terms, will persist. This will be significant for many Irish businesses trading heavily with GB. It will also affect the value of GB based businesses that trade heavily with the EU. Thankfully it won't affect trade in goods on the island of Ireland as it is now agreed that goods can move freely across the border with no tariffs, duties or paperwork, regardless of whether an FTA is agreed between the UK and EU.

Sector activity

Within which sectors would you anticipate the most acquisitions to occur in Ireland 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 Irish 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.

The Financial Services sector is one to watch for 2020, with significant levels of transaction activity in 2019, driven by sector consolidation and a desire to expand FinTech offerings.

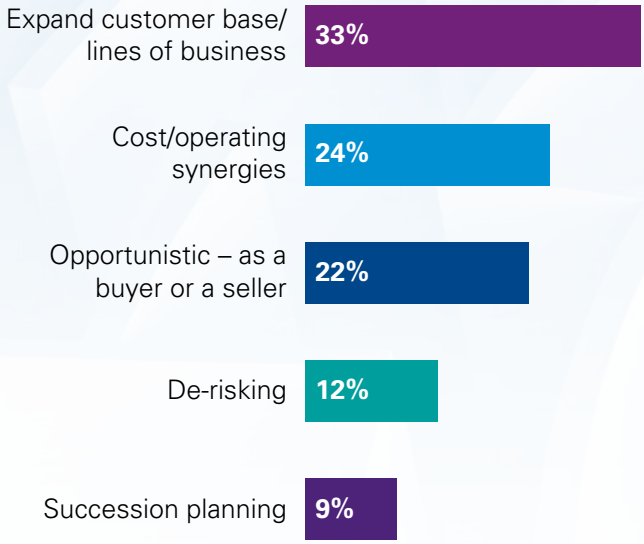
NIALL FLOOD
Director, Corporate Finance
KPMG in Ireland

KPMG Insight

Irish Technology companies have consistently demonstrated strong track records in building disruptive and innovative businesses that attract the attention of strategic buyers globally. This eco-system continues to produce high calibre companies that grow rapidly, command contractually recurring revenues and create strategic value. As a result, Technology M&A in Ireland should remain strong in 2020. Factors underpinning this trend include transitioning to the cloud, software-as-a-service becoming important in all industries, major financial institutions seeking to future-proof the business models that FinTechs threaten, as well as the increasing value of data and analytics. In 2020, we expect transactional activity levels within the FinTech, HealthTech, Cybersecurity, Big Data and AI sectors to remain strong. Furthermore, we forecast healthy 2020 deal-flow in Digital Media, AutoTech, Enterprise Software Systems, Telco Infrastructure and InsureTech. The most important factors in delivering successful exits in this sector include developing robust and ambitious valuation arguments and running competitive sales processes with good momentum levels.

Deal drivers

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



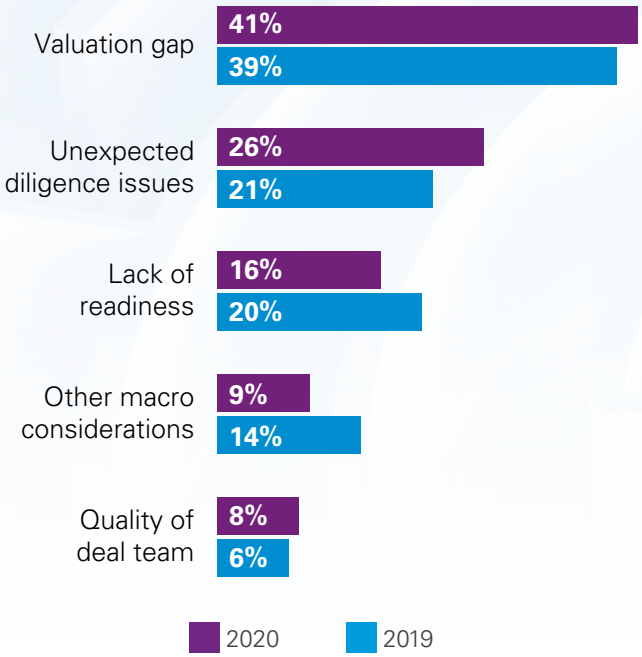
Commercial objectives, to either expand or create synergies, are the primary imperatives expected to stimulate deal making in 2020.

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 Irish M&A activity.

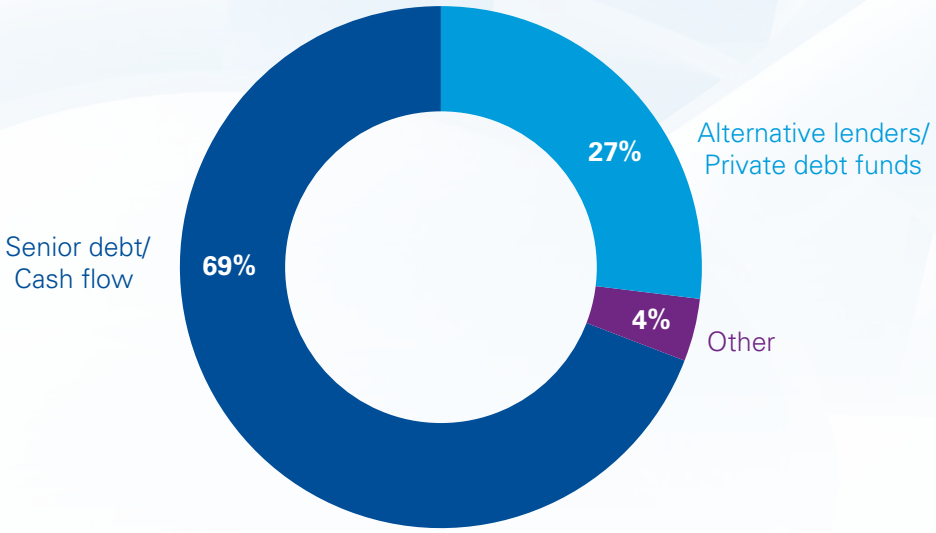
In our experience, where valuation gaps initially appeared fatal, we have seen more nuanced and balanced approaches to deal structuring keeping processes alive.

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.

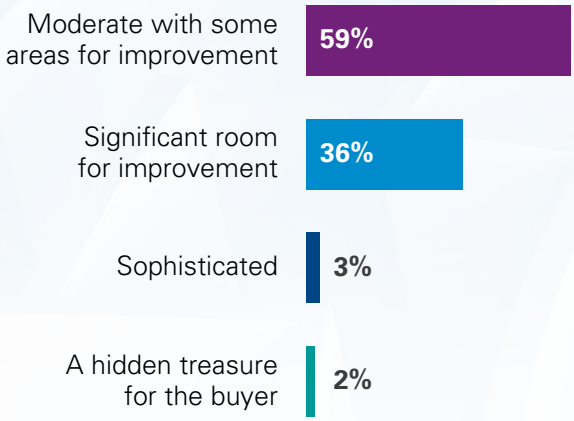
With the ever-developing banking market, corporates are actively examining the optimum blend of debt facilities and focusing on tailoring their debt packages. Requirements range from maximising leverage to ensuring sufficient capacity for seasonal cash flow variances, and corporates are routinely combining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

GAVIN SHEEHAN
Director, Transaction Services
KPMG in 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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