M&A trends in private equity

Deal making that made history

2021

kpmg.com

Introduction **p. 2**

By the numbers **p. 4**

Deep dives – Labor **p. 5**

Deep dives – Procurement **p. 6**

Deep dives – ESG **p. 7**

Outlook **p. 9**

Introduction

A record-shattering year

Private-equity (PE) deal making in 2021 hit an all-time high in both volume and value across nearly every industry. Overall deal volume increased by 35 percent from the previous year, while deal value jumped by 77 percent. Major factors driving the PE market included:

- Ample dry powder
- More capital allocated for acquisitions by PE investors due to low interest rates
- Accelerated adoption of trends such as digitization of business processes and investor demands for ESG (environmental, social, and governance) performance
- The Biden administration's proposed hikes of the marginal capital-gains tax rate and top corporate tax rate that accelerated deal activity.[1]

Here are some of the key PE investing trends in 2021:

First, the U.S. was the leading market. Domestic deals made up the bulk of all PE transactions (72 percent in 2021 compared to 75 percent in 2020). Outbound deals increased slightly to 23 percent of total deal volume in 2021 from 21 percent in 2020.

Second, overall PE deal value surged, reflecting several high-value transactions. The technology, media, and telecom (TMT) and industrial manufacturing (IM) sectors led deals by value, together constituting more than 60 percent. Volume-wise, TMT deals rose 50 percent, primarily driven by increasing demand in digital transformation along with a strong push to acquire next-generation technical capabilities, cloud-first tech stacks and cybersecurity, such as the $14 billion McAfee deal in November 2021.

The biggest growth in PE deals was in healthcare and life sciences (HCLS) and consumer and retail (C&R), which were up 132 percent and 90 percent, respectively, in deal value. Notable transactions included the $34 billion takeover of Medline Industries by Blackstone and Carlyle groups and the $9.6 billion acquisition of Wm Morrison Supermarkets by Clayton, Dubilier & Rice.

Third, special-purpose acquisition companies (SPACs) continued to gain in popularity as an exit strategy for PE investors. While the momentum of new SPAC issuances declined after Q2'21 because of tougher regulations, SPAC activities remained higher than the prepandemic levels. Potential rule changes along with mixed views on stock market performance may dampen the use of SPACs as a PE exit option in 2022.

Lastly, PE firms increasingly incorporated ESG-driven investments into their portfolios. The focus on ESG could be seen especially in the rise in deal activity in the clean and renewable energy sector—for example, KKR's investment in Sol Systems in July 2021. (See page 7 for more on PE's growing interest in ESG.)

In 2022, abundant liquidity and dry powder (more than $1.3 trillion globally, see chart on p. 3) are likely to drive continued high levels of PE M&A activity. Potential headwinds include high valuation multiples, inflation, rising tax rates, and possible new COVID-19 waves. On the one hand, rising wages and prices increase companies' operating expenses, which make high valuations more challenging. On the other hand, the Federal Reserve's monetary policy presents uncertainties that could constrain the growth of the PE M&A market. As inflation continues in 2022, the Fed has signaled its willingness to raise rates to calm inflationary expectations.[2]

Key statistics

35% increase in total PE deal volume from 2020 to 2021 (7,549 to 10,206).

77% increase in total PE deal value from 2020 to 2021 ($565 billion to $1 trillion).

+132% increase in PE deal value in HCLS in 2021.

[1] Source: Investopedia, "Biden's Tax Plan: What's Enacted, What's Proposed," April 28, 2021

[2] Source: KPMG, "Reflation vs Stagflation: The Great Policy Showdown," November 18, 2021

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

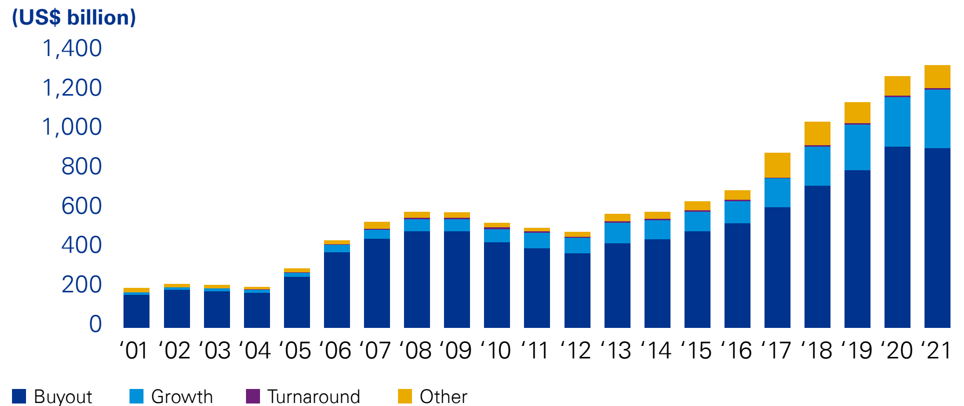
While a more hawkish monetary policy may cool PE investment, appetite for deal making remains strong. In a recent KPMG survey that polled 345 senior executives of PE firms, and private and pubic companies across all industries, 65 percent of companies surveyed plan to increase their deal activity in 2022 to gain competitive edge. The competition for a limited number of valuable or innovative targets will likely keep upward pressure on multiples. In fact, 84 percent of the respondents believe that valuations will continue to rise in 2022, and 34 percent predict the rise may exceed 10 percent.

These are some of the important trends that survey respondents cited and which PE investors and corporate executives should keep top-of-mind:

More complex M&A transactions. Nearly 90 percent of respondents agreed that deals have become far more complex, mainly due to extraordinary multiples and premiums. Value realization nowadays requires significant transformation of go-to-market and operating models.

Importance of postdeal synergies and integration. As a result of high valuations and increasing competition, dealmakers and business leaders are more focused on postdeal synergies and integration. They are leaning more heavily on revenue synergies and are seeing speedy integration and human factors as 'near-equal' value drivers as cost synergies.

Global PE dry powder 2001-2021*



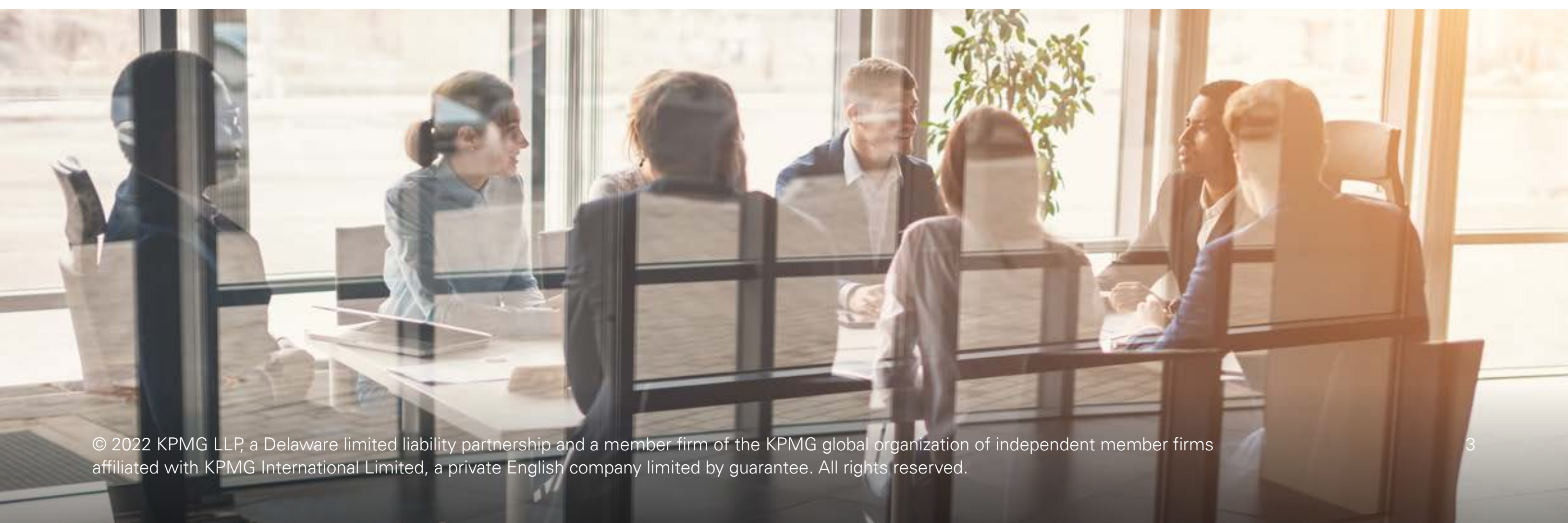
*YTD, September 2021
Source: Prequin

Poor integration and execution are seen as the largest barriers to value creation. Over 60 percent of IM investors and business leaders believe that the heightened focus on operating model integration is making deals more complex and value unlocking more challenging.

Most investors anticipate utilizing inorganic growth to access new products, services and technologies. This will prompt more frequent cross-industry and transformative deals, in which technology will play a critical role in different industries. In C&R, executives are focusing on gaining technology capabilities to accelerate e-commerce and get closer to the customer; in financial services, digital transformation and fintech continue be the focus of M&A; and in TMT, nearly half of the respondents chose artificial intelligence and machine learning as the top subsector they will engage a transaction in, while over three-quarters are considering expanding into adjacent sectors such as fintech to gain new capabilities.

Dan DenBoer
Principal
Deal Advisory & Strategy

Grace Wang
Director
Deal Advisory & Strategy



© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

By the numbers

Flush with cash and hungry for deals

In 2021, PE deals broke records by a mile. PE firms had also turned in a record year in 2020, with 7,549 deals worth a total of $565.1 billion. But in 2021, they topped those numbers by 35 percent in deal volume (10,206) and a resounding 77 percent in deal value ($1 trillion).

Despite the rapid growth in HCLS and C&R, IM led both in deal volume (3,981) and value ($322 billion), followed by TMT with 2,687 deals worth $287 billion. The biggest growth in deal volume was in TMT at 50 percent, while in deal value HCLS outperformed all other sectors with 132 percent year-on-year growth.

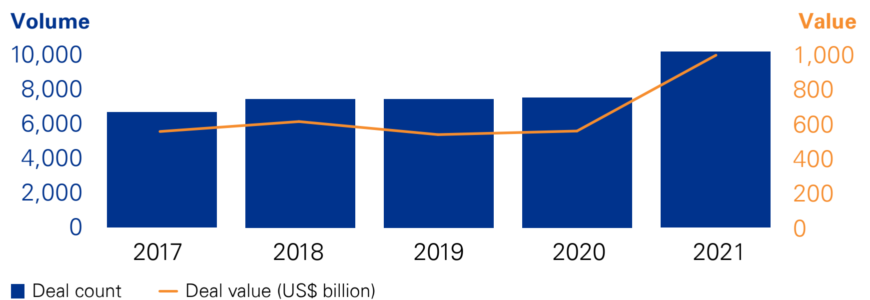
Domestic transactions dominated PE deal making, with 72 percent of total deal volume and 61 percent of total deal value. In comparison, outbound transactions (U.S. buyers of foreign assets) represented 23 percent of deal volume and 34 percent of deal value. Inbound transactions only made up 4 percent of deal volume and 5 percent of deal value.

PE funds benefited from a record year in IPOs, which hit an all-time high of 906 and raised $258.9 billion in 2021. And 59 percent of these were IPOs by SPACs, which served as an exit vehicle for some PE funds.[3]

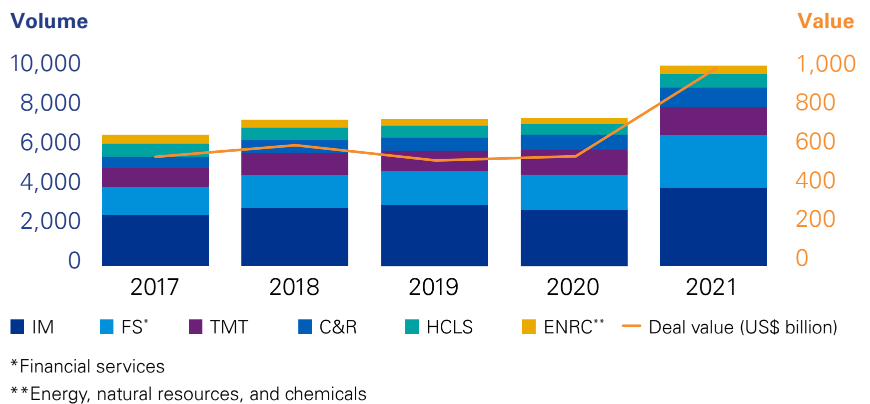
Top PE deals 2021

Investors	Target	Value (billions)
Singapore Investment Corporation, Hellman & Friedman, Abu Dhabi Investment Authority, The Blackstone Group, The Carlyle Group	Medline Industries	$34.0
Bain Capital, Bain Capital Tech Opportunities, Singapore Investment Corporation, Hellman & Friedman	Athenahealth	$17.0
Global Infrastructure Partners, Kohlberg Kravis Roberts	CyrusOne	$15.0

PE deal volume and value



U.S. PE activity by sector



*Financial services

**Energy, natural resources, and chemicals

About the data: Data was sourced from CapitalIQ, Refinitiv, Pitchbook, and KPMG analysis. The values and volumes data cited are for U.S. deals announced during each quarter. Previously published statistics may be restated to incorporate new data and/or changes in deal outcomes.

[3] Source: PitchBook, "PE exits are on a historic run as firms net billions," October 26, 2021

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The Great Resignation:
War for talent

Pandemic-triggered trends are still roiling the labor market. In the "Great Resignation" of 2021, a record number of people quit their jobs—4.5 million people did so in November alone in the U.S.[4] This is forcing many employers, including PE firms, to scramble for new employees.

The war for talent touches on three areas of PE firms' HR strategy: executive recruitment; staff retention; and automation.

Executive recruitment:
More than a quarter (27 percent) of venture-capital, corporate venture-capital, and PE firms lost a partner or key recruit to competitors or self-owned enterprises last year, a survey of more than 760 respondents found.[5] Executives with a track record of success are finding that there's no shortage of opportunities and are fielding multiple offers. Efforts to replace them are taking up more of leadership's attention than ever before. Many firms are offering higher compensation as well as a variety of incentives, including equity and signing bonuses.

Staff retention:
Remote work has altered employee expectations, and many PE professionals are permanently relocating from traditional hubs, especially to lower tax areas.[6] To retain employees who are at principal, vice-president, and senior-associate levels, firms are adapting corporate culture by loosening traditional organizational structures and geographic restrictions. Higher compensation won't always persuade those employees who place greater value on working in a caring organization that is diverse, inclusive, and environmentally committed.

Automation:
Portfolio companies of PE funds, like many others, are turning to automation to reduce labor costs. Difficulties in hiring new workers are accelerating the move to digitize low-skilled functions—a trend that was well underway before COVID-19 hit. Firms are increasing investment in equipment and deploying new technologies, especially in machine learning and artificial intelligence, for EBIDTA improvements.

HR strategy in M&A:
In the coming months, the Great Resignation will also compel PE firms to adjust their strategy when assessing companies to acquire. A PE transaction can accelerate an exodus—especially of more successful and talented employees, who are more likely to leave. It may be necessary to perform heavier up-front due diligence on the target's human-capital problems and potential and enhance retention strategies to keep key personnel. Depending on the quality and quantity of skilled human capital available, a PE firm may choose to pursue one company over another.

At the same time, PE firms in old industries cannot take for granted that more pay alone will persuade unskilled labor to stay in jobs they don't find meaningful. Such firms would be advised to continue investing in automation to control costs and consider scaling down growth plans.

Misha Edel
Managing Director
Labor
Deal Advisory & Strategy

[4] Source: Roy Maurer, "Record 4.5 Million Workers Quit in November," SHRM, January 4, 2022

[5] Source: Priyamvada Mathur, "VC, PE firms resort to salary hikes amid historic quitting spree," J.Thelander/PitchBook, September 23, 2021

[6] Source: Jonathan Goldstein and John Rubinetti, "2021 North American Private Equity Investment Professional Compensation Survey," Heidrick & Struggles, 2021

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Procurement excellence:
Helping portfolio companies deal with cost pressures

Prices rose across the board in 2021, and inflationary pressures are expected to continue in 2022. Double-digit price hikes caused by supply-chain disruptions are hitting companies' margins hard, particularly in the manufacturing, construction, and trade sectors. Rising input prices pose challenges to PE firms, both in running their portfolio companies and in vetting potential acquisitions.

The jump in inflation undermines PE buyer assumptions and threatens fund performance. Periods of volatile pricing call for extra discipline and planning—to reduce damage and vulnerabilities in existing holdings, as well as when doing due diligence of new targets.

To better understand the risks to future margins, there are certain tough, key questions PE firms can ask management of portfolio companies and targets:[7]

Do contracts guarantee supply continuity?
In a volatile period, suppliers may attempt to take advantage of circumstances to force price hikes. Smart buyers add more performance guarantees in their supply contracts: they may more narrowly define force majeure or remove allocation clauses to mitigate the damage of unforeseen disruptive events such as fire or flood. At the same time, such continuity guarantees should be coupled with a mechanism for price increases or decreases to manage volatility.

Is there price transparency for direct materials?
It is crucial to demand ongoing price transparency. In periods of volatility, budgets often uncouple from actual prices with disastrous results for profitability. Price transparency should be detailed, and buyers can retain the right to withhold payment where transparency is not provided for cost increases.

Are direct materials costs indexed?
Indexing might seem like an obvious remedy for price volatility, but it only makes sense for the buyer under certain circumstances—such as when the supplier has limited ability to control materials costs, and when these represent a high percentage of the buyer's purchase costs.

Can suppliers meet buyer needs?
Another commonly overlooked risk is the supplier's ability to scale supply. Whole sectors are being held back by commodity shortages—just look at the automotive sector's current low inventories caused by the ongoing microchip shortage. Even if a supplier is resilient, it's almost always a good idea to find a second source. Dual sourcing makes disruptions less likely, and introducing competition can help keep prices nearer to the market-clearing price.

Is the technical expertise to handle price spikes available?
With costs bouncing, it's a good time to make sure that there is enough technical expertise on tap to limit materials price increases when contracts and other commercial levers fail. Companies might consider an audit of suppliers' contracts to check that their price hikes are allowed under current agreements. In this environment, sellers are often tempted to push past the letter of the contract or manipulate a buyer into breaking it off.

Is there a structured price-management committee?
It's important to have governance in place across procurement and business stakeholders to better understand why prices may increase, their impact on performance, and how to develop a mitigation strategy.

Thoughtful responses to these questions will help PE firms keep the supply chains of portfolio companies resilient and spot potential problems lurking in targets' operations. In a highly uncertain price environment, "buyer beware" is an even sounder rule than usual.

Randy Fike
Managing Director
Procurement
Deal Advisory & Strategy

[7] Source: KPMG, "When the price is wrong: How should you handle today's price spikes and materials shortages?" 2021

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ESG:

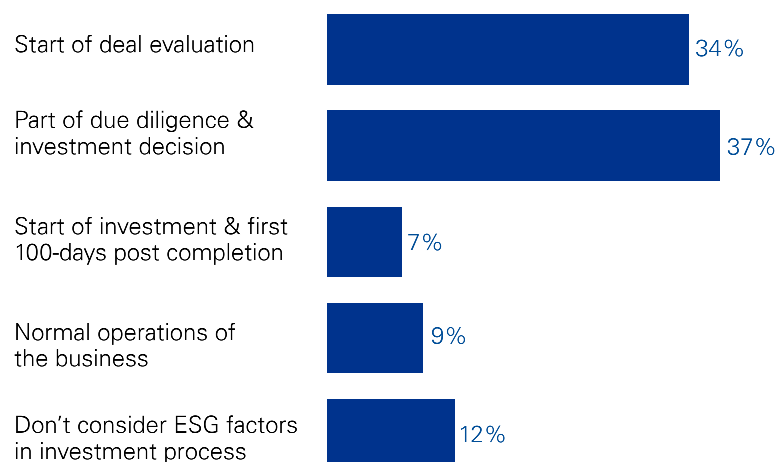
Getting serious about ESG

In 2021, ESG became a top priority for PE firms. Like institutional shareholders in public companies, PE limited partners are pushing funds to step up efforts to address environmental, social, and governance issues. There is growing belief that companies with strong ESG scores will command a premium.[8]

ESG has thus become a factor in how funds evaluate assets and how they manage portfolio companies. And, like other managers, PE executives are developing ESG skills so they can turn ESG from a compliance burden to an opportunity to create value. More and more PE funds are addressing ESG earlier in the investment lifecycle (see chart).

When during the deal cycle do you first evaluate ESG considerations?

% of respondents, n=95



Source: KPMG U.K.

Pre-deal:

Incorporating ESG principles into deal evaluation and due diligence

— PE firms are increasingly incorporating ESG into every due diligence, using as a minimum risk-management and value-preservation lenses to evaluate publicly available and target-provided data.

— During diligence, leading PE firms are supplementing the available data with "outside-in" analyses premised on estimating a target's greenhouse gases baseline, comparing a target's emission profile to peers, constructing an estimated ESG rating, assessing the impact and potential cost of climate change on a target's operations, and creating a forward-looking assessment of how changes—regulation, technology, market demand, others—impact the business.

— PE firms with more advanced capabilities are not only assessing a target's ESG profile but also mapping postclose ESG opportunities. Examples include: deconstructing a target's ESG rating to identify levers to pull; employing analytics to get under the covers of a target's DEI profile—going beyond diversity "snapshots" (i.e., share of employees in various diversity categories) to better "equity," and "inclusion" measures—in order to identify high-leverage opportunities to drive improvements; and assessing a target's decarbonization plan to accelerate high ROI opportunities (e.g., renewable power purchase agreements).

[8] Source: Harvard Law School Forum on Corporate Governance, "ESG Matters," January 14, 2020

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Tenure:

Incorporating ESG into value-creation plans

— Once a targeted asset becomes part of its portfolio, the PE firm may continue to ramp up the acquisition's ESG efforts. These typically involve streamlined ESG materiality assessments, baseline emissions measurements, climate-risk assessments of the asset and its supply chain, ESG target setting, and standing up ESG programs.

— PE firms can also take a value-creation approach across the portfolio, which may contain businesses that are not yet advancing on ESG. By improving ESG performance, PE owners can increase valuation and make these assets more attractive to potential buyers, who may be shopping for ESG-enhancing businesses.

Exit:

Using ESG to enhance the exit story and achieve higher multiples

— As they prepare assets for sale, some PE firms are providing ESG reports to speed up the sales process, signal to ESG-oriented buyers, and maximize value. Some PE-held firms preparing for an exit via an IPO are also touting a credible ESG focus and track record as key differentiators as investors shift more dollars to sustainability plays.

In 2022, we expect more and more organizations will look for ways to create value through ESG efforts. Like corporates, PE firms now have no choice but to deal with ESG head-on. But PE firms that develop strong ESG-management capabilities and embed ESG into every phase of the investment cycle—and into the strategies of portfolio companies—can earn an ESG premium.

Mark Golovcsenko
Principal
ESG
Deal Advisory & Strategy

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Outlook

Money is there and so is the inflation threat

The coming year looks more challenging than 2021, but PE dealmakers should remain busy mainly because they have no shortage of ready capital in search of opportune investments. Still, high valuations for most sought-after targets and macroeconomic headwinds could constrain PE firms' M&A prospects more than expected.

Heading into 2022, the U.S. economy was contending with the rapid spread of the Omicron variant and the resulting disruptions to consumer spending and supply chains. We expect GDP growth to fall to around 2.5 percent in Q1'22. While economic challenges may hamper growth in the first half of the year, we do not expect them to derail the ongoing recovery. In fact, a return to normal will shift spending from goods to services, as consumers re-engage in social activities. We remain cautiously optimistic that full-year GDP growth of 3.5 percent is possible in 2022.

The labor market will remain tight. With the economy at full employment—the unemployment rate was 4 percent in January 2022—upward pressures on wages will continue. This means many PE firms, like others, will find themselves scrambling for employees and will need to rethink their strategies for recruitment, retention, and compensation (see "War for talent," p. 5).

The biggest macroeconomic concern is inflation, which hit a 40-year high of 7 percent (year-over-year) in December. The risk of continuing disruptions from COVID-19 is that inflation may have yet to peak, even though we expect it to fall to around 4 percent by December 2022. The Federal Reserve is already under pressure to raise interest rates faster and more than the three hikes it has hinted at.[9] Businesses could face lower margins and higher borrowing costs than expected, causing a retrenchment in capital spending.

PE firms will no doubt keep close tabs on all these trends and continually recalibrate their strategies to react proactively to changing market conditions. Appetite for deals remains robust, and 2022 may very well turn out to be another impressive M&A year for PE dealmakers.

Key considerations as we look ahead

To successfully navigate a more uncertain deal landscape, PE firms should focus on:

1. Setting fit-for-purpose investment strategies with appropriate attention on growth, cost, operation, and holistic/vertical integration potential.
2. Finding extra value through more rigorous postmerger integration and value creation with in-depth functional considerations such as technology and labor.
3. Continuously driving forward ESG, leveraging and integrating ESG as an inherent part of M&A strategy.

[9] Source: Federal Reserve, "Transcript of Chair Powell's Press Conference," January 26, 2022

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Authors

Dan DenBoer
Principal
Deal Advisory & Strategy
773-294-5042
ddenboer@kpmg.com

Joe Hartman
Partner
Deal Advisory & Strategy
312-665-2489
jhartman@kpmg.com

Mark Golovcsenko
Principal
Deal Advisory & Strategy
917-375-2889
mgolovsenko@kpmg.com

Misha Edel
Managing Director
Deal Advisory & Strategy
510-282-9758
mishaedel@kpmg.com

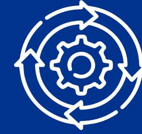
Randy Fike
Managing Director
Deal Advisory & Strategy
850-247-5888
rfike@kpmg.com

Rebecca Brokmeier
Managing Director
Corporate Finance
312-665-3152
rbrokmeier@kpmg.com

Chrisanne Corbett
Managing Director
Corporate Finance
312-665-2779
ccorbett@kpmg.com

Grace Wang
Director
Deal Advisory & Strategy
319-541-9739
gracewang3@kpmg.com

We would like to thank our contributors:
Sanjay Sehgal, Paul de Janosi, Daniel Smith, Geoff Lewis, Charles Lee, and Brian Winters.



How we can help you

At the KPMG Strategy - Private Equity practice, we understand the unique requirements of private equity. Our private equity team works with your fund, operating partners, and portfolio companies to realize your ambition to buy, sell, finance, and drive performance, on both the buy side and sell side.

We provide dedicated functional capability and focused solutions across deal lifecycle and portfolio value optimization. Our innovative approaches drive strategy and execution across deals and value creation that includes industry expertise across the full portfolio management process. We also have deep advanced analytics capabilities that provide detailed diagnostic insights, enabling us to quickly drive results.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.
DASD-2022-6169