Innovation, complexity and disruption define the new M&A market
Key global M&A findings

- 56% of companies expect to pursue acquisitions in the next 12 months
- 73% of M&A activity will be innovative investment
- 50% increase in intent to pursue upper-middle-market deals
- 47% of companies intend to complete more deals than in the prior year
- 45% are proactively guarding against cyber breaches in their M&A process
A note from our Global Transaction Advisory Services Vice Chair

Innovation, complexity and disruption define the new M&A market

Our 12th Global Capital Confidence Barometer finds the global M&A market maintaining the positive momentum that developed during 2014. For the first time in five years, more than half of our respondents are planning acquisitions in the next 12 months, as deal pipelines continue to expand.

Executives express increasing optimism in the global economy, with much broader consistency across geographies than in 2014. This economic optimism, combined with steady confidence in corporate earnings and other leading market indicators, is fostering an environment where companies are preparing bolder moves, including M&A, to generate future value.

Our survey reveals three key reasons for the sharp increase in dealmaking intentions. First is the arrival of new entrants – both start-ups and companies returning to the market after staying on the sidelines for several years. Second, divergent economic conditions are accelerating cross-border M&A, as existing momentum in many developed markets is further fueled by falling oil prices and currency fluctuation. And third, disruptive innovation is driving dealmaking at every level of the enterprise.

Of course, challenges remain prominent on the boardroom agenda. Greater volatility in commodity and currency markets, geographic divergence in economic conditions and monetary policies, and lingering geopolitical concerns all present complexity. As well, rapid technological change is creating new risks such as cybersecurity, which has emerged as a core business issue that must be managed as part of the dealmaking process.

Notwithstanding these risks, the overall view in this Barometer is of a global M&A market on an upswing after years of crisis. Companies are learning to create opportunity and drive growth amid a more competitive economic and geopolitical landscape. After a half-decade of stagnation, we are seeing the bold beginnings of a new kind of M&A market – one marked by innovation, complexity and disruptive change.

Pip McCrostie
Global Vice Chair
Transaction Advisory Services
Key automotive sector findings

70% of companies expect to pursue acquisitions in the next 12 months

68% of M&A activity will be innovative investment

50% increase in intent to pursue upper-middle-market deals

59% of companies intend to complete more deals than in the prior year

50% are proactively guarding against cyber breaches in their M&A process
Anticipation of transactions has never been higher in the automotive sector

Our most recent Capital Confidence Barometer survey finds 70% of survey respondents expecting to pursue acquisitions in the next 12 months. In the six years we have conducted our survey, we have not experienced such anticipation, ever. The automotive sector continues to experience positive trends in most established markets, including positive sentiment around growth, albeit slow, throughout the Eurozone. Growth expectations in China, India and other leading emerging markets have been adjusted but are still positioned to exceed those in mature markets.

This Barometer finds a heavy weighting toward middle market transactions, those with a value of up to US$250 million. In addition, there is a significant focus around increasing investments in new products and expanding the mix of existing products and services. Cost reduction and operational efficiencies continue to weigh heavily on investment decisions. Geographic expansion is no longer a key driver to transaction strategies.

Our survey indicates political stability as a continuing and primary concern regarding strategy. Of particular interest is the growing concern regarding cybersecurity and possible threats related to strategy, transaction executions and reputational damage.

Overall, we believe the increased interest in acquisitions will especially benefit automotive companies that have evaluated the long-term strategic fit of portfolio businesses and are making preparations to divest non-core or non-strategic operations.

Mark Short,
Global Automotive Industry Leader,
Transaction Advisory Services
An overwhelmingly positive outlook for the global economy and a continued robust outlook for corporate earnings and other leading market indicators, including credit availability, should combine to support a healthy M&A environment over the next 12 months.
Automotive executives see sustained momentum in broader global economy

The vast majority of automotive executives now see the global economy as improving, up strongly from a year ago. Our survey shows broad-based confidence across all geographies. In 2014, only the US, UK and China were fueling economic optimism. In 2015, multiple engines are powering the global economy: a US economy moving from perceivable to unequivocal growth, China moderating but still growing and a Eurozone economy moving past austerity in its stronger economies and managing risk elsewhere. While significant downside risks remain, executives are increasingly focused on capturing the potential upsides of global economic growth.

Leading market indicators remain positive

Our Barometer indicates some reduction in confidence in corporate earnings growth from six months ago but it still remains high. This sentiment may reflect a corporate environment entering a new phase. Many companies are experiencing diminishing returns from shorter-term cost-cutting and efficiency programs instigated at the outset of the global financial crisis.

Confidence in credit availability has increased dramatically over the last 12 months. In April 2015, 74% of our automotive respondents expressed confidence in access to credit, a big jump from 48% a year ago.

Battle for talent heats up as companies look to recruit and retain

A new phase of the global employment picture appears to be at hand. Companies are not only growing their workforce but are also under pressure to retain the best talent. Fifty-eight percent of automotive executives say they are maintaining their workforce size. Meanwhile, the number expecting to grow their workforce is down from six months earlier but remains nearly equal with a year ago.

Geopolitical concerns persist; commodity and currency volatility rises

Unsurprisingly, when automotive companies consider the major risks to their business, the largest number view the ongoing geopolitical issues – from Eastern Europe to the Middle East – as the greatest concern. What is perhaps surprising, and might have been unforeseen as recently as six months ago, is how the sharp fall in commodity prices and increasing volatility in currencies have grown as major concerns. These issues rank a strong second place to geopolitics among business risks.
Corporate strategy

Cost reduction continues as a perennial focus, but in a fast-changing world, automotive companies are pursuing innovative growth strategies to improve their market positioning.

86% of companies are focused on innovative organic growth strategies.
Intense cost scrutiny is now an everyday feature of corporate strategy

Cost discipline is now embedded in corporate DNA – even as the global economy moves past crisis mode. A low-growth, low inflation environment compels automotive executives to keep a tight rein on cost structure, as increased expenses cannot easily be passed on to customers. This cost focus is exacerbated in the short term by greater currency volatility and fluctuations in commodity pricing.

Innovative organic strategies targeted to boost market footprint

Given the overwhelming view that the global economy is expected to improve – coupled with the disruptive forces affecting all industries – executives are now more likely to pursue innovative growth strategies. These strategies include increasing R&D, entering new markets, considering new services and exploiting technological change.

To be sure, focus on core operations remains a priority. However, the definition of “core” continues to evolve, as technological change and disruptive competitors continue to redefine the essence of a company’s business. Companies must protect and grow this ever-evolving core while accessing new opportunities, as they seek to expand their market footprint and protect their competitive position.

The definition of “core” operations continues to evolve. Technological change and disruptive competitors are redefining the essence of a company’s business.
Which of the following will impact your core business and your acquisition strategy most in the next 12 months?

**Global marketplace — Economic power shifts east and south, driving patterns of trade and investment**

Faster growth rates and favorable demographics in key emerging markets are expected to feature prominently over the next decade, as the gap between developed and emerging countries continues to shrink and a new tier of emerging nations is driven by its own nascent middle classes. Increasingly, innovation is taking place in emerging markets, with Asia as a major hub. At the same time, the battle for talent will be increasingly fierce, driving greater workforce diversity to secure competitive advantage.

The world’s economies are expected to remain highly interdependent – via trade, investment and financial systems – driving the need for stronger policy coordination among nations and resilient supply chains for companies operating in this environment. At the same time, domestic interests will continue to compete with the forces of global integration. These trends will affect companies’ core business and acquisition strategies regardless of location, but executives nonetheless must consider not only what they do, but where they operate.

**Entrepreneurship rising — Growth in global entrepreneur class will require more supportive ecosystems**

Entrepreneurs are the lifeblood of economic growth worldwide, both as employers and as producers of innovative products and services. They drive upstream and downstream value-chain activities. The growth and prosperity of all economies – developed and emerging – rely on robust entrepreneurial activity.

While some entrepreneurial activity is still motivated by necessity, “high-impact” entrepreneurship, once largely confined to mature markets, now drives emerging market expansion. Indeed, many emerging-market entrepreneurs are building scalable enterprises that capitalize on local needs and serve as business role models.

The rise of this entrepreneurial spirit is accelerating the introduction of new entrants to sectors that rely on intellectual property, such as automotive. This means both challenges for existing players and opportunities as innovative start-ups attract M&A activity.

**Digital future — Technology is disrupting all areas of enterprise, driving opportunities and challenges**

Fueled by the convergence of social, mobile, cloud and big data, and the growing demand for anytime, anywhere access, technology is disrupting all areas of the enterprise – across industries and geographies.

The evolution of the digital enterprise also presents significant challenges: new competition, changing customer engagement and business models, unprecedented transparency, privacy concerns and cybersecurity threats. Companies that seize the opportunities offered by digital advances stand to gain; those that cannot may lose everything. Relationships between companies are becoming more fluid, as partners in one channel become competitors in another.

In sum, all of these technology-driven changes make long-term corporate strategy and acquisition plans far more complex and yet require expedient decision-making.
Fundamental global changes reshaping corporate strategies

Which of the following has been elevated on your boardroom agenda?

While costs and efficiencies are always a primary boardroom topic, the recent fluctuations of currencies and commodities have further elevated the prominence of cost reduction in the short term. Cost reduction is also at the heart of the shareholder activist agenda. In this Barometer, activist influence has not been elevated relative to other issues, because it was already at a very high level. Acquisitions are a continued focus of the boardroom agenda, as companies keep their eye on value-creating transactions.

Comparing responses on the boardroom agenda (above) with our survey results (below) on the Capital Agenda — EY’s framework for companies’ strategic decisions — we see a strong correlation. Optimization is the overwhelming capital priority, topping the agenda for well over half of executives. This reinforces that even as the global economic outlook improves, companies see a rigorously efficient portfolio as essential to remain competitive and protect corporate positions.

Raising: Do we have the right capital structure to meet our strategic priorities?

With healthy balance sheets, companies are well positioned to fund deals – 35% of automotive executives expect to focus on raising capital.

Investing: What is the best way for our company to grow – and is it aligned to our core business?

Companies are currently more focused on rigorous cost management and operational efficiencies – only 10% of automotive companies are devoting their primary attention and resources to investing.

Preserving: How can we improve the performance of our assets?

As companies are out of survival mode, executives are no longer focused on preserving capital and are now turning to other Capital Agenda areas.

Optimizing: Which steps can we take to maximize our portfolio’s performance?

This is the leading Capital Agenda focus – 55% of executives are planning to optimize capital and are retaining rigor and discipline in their operations.
Continued optimism in the automotive sector – brought about by increasing sales in both developed and emerging markets and a sector-wide drive to decrease costs and improve efficiencies – is motivating increased M&A. A significant number of deals focus on acquiring emergent technologies, such as driverless cars and advanced materials.

70% of companies expect to pursue acquisitions in the next 12 months
Economic confidence, market stability strengthen M&A intentions

Last year the automotive sector was the leading industry sector for driving future transactions. Growing confidence in the global economy will further support M&A in 2015. Eighty percent of automotive executives plan to boost their dealmaking in some fashion over the next 12 months. While 37% of executives are planning bigger deals, bolt-on and complementary deal intentions are also up.

With the market already at elevated levels, it is not surprising that a greater percentage of our respondents expect M&A activity to remain stable over the next 12 months – this response is nearly even with those expecting market improvement. Given the strength of deal intentions, greater stability should provide the foundation for sustainable growth in the M&A markets.

M&A appetite remains strong in automotive sector after busy 2014

With economic sentiment broadly supporting transactions, automotive companies’ appetite for M&A is at an all-time high for our Barometer, with 70% of executives expecting to pursue acquisitions in the next 12 months.

The growing importance of product innovation and access to emergent technologies, such as driverless cars and advanced materials, are motivating factors behind a significant number of deals within the automotive sector. In addition, disruptive innovation – such as increasing convergence and blurring of defined sector lines – is driving dealmaking at every level of the enterprise. Supply chains, channels to market and back-office infrastructure are all affected by innovation, and M&A is often the best route for maintaining or gaining competitive advantage.

Two other ingredients necessary for positive M&A sentiment are the improving quality and quantity of potential targets. The quantity or inventory of assets on the market is strong, supported by private equity finally divesting long held assets and increased corporate carve-out activity. The quality of targets is also relatively strong, driven by an improving business environment and ongoing cost management and margin-improvement programs.
Pipeline growth slows, remains healthy

Automotive companies expect to complete more acquisitions

Confidence in the global economy and leading economic indicators have dealmakers in position to continue the positive M&A momentum from 2014. Nearly 60% of automotive executives expect to close more deals in the next 12 months than they did in the prior year. Most respondents also indicate that their total number of deals will be relatively small, one or two acquisitions.

Pipelines shift downward in automotive as dealmakers digest completed transactions

Deal pipelines are a key indicator of the state of the M&A market, offering context on how companies are thinking about opportunities and preparing for growth. While our automotive respondents indicate confidence supporting transactions, more than a third expect their pipelines to shrink over the next 12 months, as they incorporate recently completed deals or those already in progress.
Valuations support continued dealmaking

Potential upside pressures on asset prices, but M&A market is expected to persevere

Record-high equity markets, strengthening M&A markets and an improving global economy have all increased competition for assets. Given this environment, it is unsurprising that most automotive executives see the valuation gap widening. However, a clear majority (55%) see that gap as only somewhat higher—a sign that the deal markets are healthy but not overheated. Most important, overwhelming majorities expect both the valuation gap and the price of assets to remain stable in the next 12 months, creating conditions conducive to dealmaking.

The Eurozone is one region where valuations will likely increase, due to its new quantitative easing program. However, while some upward pressure on valuations is expected there, other factors, such as exchange rates and lower oil prices, should mitigate any significant negative effect on M&A.

Overwhelming majorities expect both the valuation gap and the price of assets to remain stable in the next 12 months, creating conditions conducive for dealmaking.
Cyber attacks are a growing risk to rebounding M&A market

Implications of a cyber attack

Potential business risks of a cyber attack include theft of R&D and intellectual property, financial fraud and reputational damage. The disruption caused by an attack may extend beyond the company itself to the industry and the broader market.

In the case of M&A specifically, companies’ systems can be hacked or compromised during the deal process, with the intent to gain insider information. One obvious risk is manipulation of the stock price and the deal process. A less obvious but equally significant risk is the potential to gain strategic information that could be used to disrupt the company’s core business and competitive position.

Identifying the risk is the key step in managing it

The M&A process centralizes an organization’s strategy and information on all of its functions in one repository. This presents a unique cyber risk situation that must be managed.

One of the most important ways to manage cyber risk during the M&A process is to proactively determine who may be targeting the organization – and which information they might want to steal. While identifying these threats, companies should consider not only potential attackers from outside the organization but also entities with authorized access, such as supply- and distribution-chain vendors as well as other business partners. Even the target company in an M&A transaction could pose a threat, because any weakness in its security program could be exploited. Once these risks are identified, preventive steps can be taken to alleviate them.

Which of the following statements do you most agree with?

- We are increasing our measures taken to protect against potential cybersecurity breaches of our M&A process.
- We are more concerned about the cybersecurity of planned acquisitions or targets than we were 12 months ago.
- We are more concerned about the business impact of potential cybersecurity breaches than we were 12 months ago.

Transactions are a prime target for cyber attacks. The M&A market rebound, coupled with heavy reliance on technology and digital assets in today’s transaction environment, is a recipe for increased cyber attack risk. More than ever, a strong process for mitigating cyber threats is imperative for all companies. Cyber attacks are a fundamental business risk, not simply a concern for the IT department.
Innovation key to growth in automotive sector

Disruptive forces driving deals
Innovation, disruptive forces, blurring of their own clear sector definitions and global megatrends are all combining to fuel M&A. In response, companies are making bolder moves to shift their business scope and maintain competitive advantage.

Accordingly, nearly 70% of automotive executives who are considering deals are eyeing these innovative investments rather than bolt-on or transformative transactions. More and more, companies are learning to anticipate future challenges to their business models and using acquisitions as a vehicle to accelerate their response.

Upper-middle-market M&A to accelerate
Looking at expected deal size, the smaller middle-market deals — those under US$250m in size — continue to dominate executives’ plans. However, since our last Barometer, the most significant growth has been in upper-middle-market deals, those above US$250m and under US$1b in size. This category has increased by nearly 50%.

While blockbuster megadeals – the dominant category in 2013 and early 2014 – have not exited the market entirely, our respondents confirm that deals over US$1b in size are not the focus of their activity.

Deals under US$250m continue to dominate executives’ plans. But the most significant growth since our last Barometer has been in upper-middle-market deals – those between US$250m and US$1b.
Dealmakers looking across borders, but relatively close to home

Automotive executives report rather low expectations for their own domestic M&A. At just 10% of planned deals, this response is well below the historic average. Ninety percent of our automotive respondents are seeking deals outside of their home country.

A major driver of this search for cross-border opportunities is companies exploiting divergent economic performance between countries and regions. Where a company operates is now as important as the segments in which it operates. Enterprises that undertake a robust portfolio review often move toward geographies that fill gaps or are ripe for disruption.

The largest category of automotive executives – more than half – are focusing their M&A strategies on cross-border transactions in their immediate region, driven by the ease of acquiring in common economic trading areas. This intention to acquire close to home is also boosted by the familiarity of investing in adjacent countries, which eases the path to cross-border M&A. However, a very sizable minority – almost 40% – are planning to acquire further afield, which highlights the increasing interconnectedness within the global economy.
Top investment destinations for automotive (outside your local market)

The United Kingdom has long been a favored destination for foreign firms accessing the wider EU market. With strong domestic growth in 2014, similar levels forecast through 2015 and a focus on reducing red tape, the UK should be able to maintain its unique status as a global M&A hub. Among leading UK sectors likely to engage in M&A, life sciences and technology companies are strong innovators, the financial services sector is robust and consumer products companies are globally recognized. All should be looking to make acquisitions both domestically and abroad and will be attractive to foreign acquirers. As for downside risks, the impending UK elections and uncertainty regarding the timing of an expected interest-rate increase—which may raise the value of the pound, especially against the euro—may check the deal markets.

The M&A market in the United States is expected to maintain its upward momentum and continues to be attractive to foreign investors. Positive US economic fundamentals, record stock markets and a low-interest-rate environment are all strengthening boardroom confidence. US companies continue to perform exceptionally—the majority of the S&P 500 beat 2014 earnings and sales estimates—keeping investor morale up and driving M&A. The dollar’s increasing value should also make outbound deals appealing, especially those focused on the Eurozone, where valuation and currency differentials are most apparent. The main potential downside for dealmakers in the US concerns the timing of the Federal Reserve’s first anticipated rate hike following the end of quantitative easing and the overall pace of the return to normalized interest rates; however, recent Fed announcements have helped allay these concerns.

Even amid headlines over its recent economic slowdown, mainland China remains a very attractive destination due to levels of growth that remain very strong relative to the global economy. The Chinese Government now targets annual growth at 7%, down from previous growth rates that ranged as high as 10%. However, there is no expectation of a hard landing or significantly greater deceleration. With economic rebalancing a stated Chinese policy, further investment opportunities should arise for inbound investors. The central bank has yet again lowered interest rates to stimulate the economy, providing a more favorable environment for M&A. The Government has also introduced a range of measures to encourage outbound acquisitions by Chinese companies, particularly targeting companies with intellectual property assets in the industrial and technology sectors.

Germany has been the main bright spot within an otherwise depressed Eurozone. Recent economic releases and Purchasing Managers Index surveys point to an acceleration of growth, though it is still relatively low compared with historic averages. Germany’s high-quality corporate assets, especially in the industrials, chemicals and automotive sectors, are already attractive to foreign acquirers, and a weakening euro promises to make these assets relatively less expensive. The main competition for these assets is likely to come from China, Japan and the US. As for M&A within Germany, acquisitions by German companies have historically been focused on the domestic market, but we are beginning to see cross-border acquisitions strengthening, especially those focused on the US.
The Global Capital Confidence Barometer gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY’s framework for strategically managing capital.

It is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel comprises select global EY clients and contacts and regular EIU contributors.

- In February and March, we surveyed a panel of more than 1,600 executives in 54 countries; more than half were CEOs, CFOs and other C-level executives.
- Automotive sector companies represented in this survey:
  - 26% with revenues greater than US$5b
  - 41% with revenues between US$1b–US$4.9b
  - 20% with revenues between US$500m–US$999.9m
  - 13% with revenues less than US$500m
  - 64% publicly listed
  - 33% privately owned
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