A fresh take on tech

Cisco CFO Kelly Kramer on deals, driving growth and the race for innovation
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Pfizer’s announcement of its intention to buy Allergan in late November saw 2015 M&A break the all-time record for value, reaching US$3.8t, surpassing the 2007 figure. The appetite to snap up prized assets is clearly hitting new highs.

The findings of our latest Capital Confidence Barometer (CCB) bear this out. Fifty-nine percent of companies expect to pursue deals in the coming year – the highest appetite for M&A in six years. On top of this, appetite for upper-middle-market deals has increased by 24% since the last CCB in April. In a low organic growth environment, companies are increasingly willing to undertake M&A as a way to expand.

This activity is testimony to several new factors in the deal markets. For one, innovation has become a huge factor in driving deals. Just under three quarters of CCB respondents cited innovative investment as defining planned M&A activity. As well as the fast pace of technological advances, demographic developments and changing customer preferences also provide an imperative to do deals to stay ahead.

In addition, digital disruption is blurring the lines between separate sectors. Forty-eight percent of respondents said they were planning an acquisition outside of their primary sector in the next year. We look into industry convergence (p 28) and how disruptive tech is transforming dealmaking (p 31) in more detail in our special ‘cyber’ edition of Capital Insights.

While deal activity is high, there is always a risk that geopolitical events could derail optimistic M&A intentions. Greater uncertainty around emerging economy growth and divergent monetary policy in developed markets may also have an impact.

However, with companies eager to grow and keep pace with a changing business world, the outlook for dealmaking in 2016 still looks very bright.

Pip McCrostie
Global Vice Chair
Transaction Advisory Services, EY

If you have any feedback or questions, please email editor@capitalinsights.ey.com

For more insights, visit capitalinsights.ey.com, where you can find our latest thought leadership, including our market-leading Capital Confidence Barometer.
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1,681
By the end of September, 2015 had produced only 1,681 mid-market transactions, worth a combined US$208.9b.

Contributors: Dan Burton, CEO, Health Catalyst; Gavin Davies, Partner, Herbert Smith Freehills LLP; Timothy Galpin, Ph.D., Clinical Professor of Management, Colorado State University; Tim Gee, Global Head of M&A, Baker & McKenzie; David Gibson, Vice President of Strategy, Varonis; Robert Griesmeyer, Partner, Andrews Kurth LLP; Anthony Hill, Director, Intralinks Dealnexus; Andrew Hornigold, Partner, Pinsent Masons; John Kelly, Senior Vice President, IBM Research and Solutions Portfolio; Kelly Kramer, CFO, Cisco Systems; Gianvito Lanzolla, Professor of Strategic Leadership, Cass Business School; Richard Lukaj, Senior Managing Director, Bank Street Group; Heinz Meierkord, CEO, Advansa; Mandy Merron, Partner, Kingston Smith LLP; Scott Moeller, Director of M&A Research Centre, Cass Business School; Phyllis Newhouse, CEO, Xtreme Solutions; David Patt, Senior Analyst, Legal & General Investment Management; Gregor Pryor, Partner, Reed Smith; Sam Riley, Chief Executive, ansarada; Brendan Rizzo, Technical Director EMEA, HP Enterprise Security; Bob Rubino, Head of Corporate Finance and Capital Markets, Citizens Commercial Bank; Matt Spetzler, Partner, Francisco Partners; Colin Welsh, CEO, Simmons International; Linda Yueh, London Business School

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This quarter’s theme: The digital disruption of M&A
From cybersecurity to digital due diligence, technology is changing the face of deals
M&A: the force awakens

From megadeals to inversions, hostile takeovers to lucrative carve-outs, 2015 saw M&A climb back to the very pinnacle of the business agenda. November’s US$155b deal between life sciences’ giants Pfizer and Allergan pushed the total M&A value for the year to US$3.8t — 4.3% above the previous record of US$3.65t, set in the heady pre-crisis days of 2007.

It has been a year defined by soaring corporate confidence, bulging balance sheets, convergence deals and, above all, megadeals. Aside from the aforementioned Pfizer and Allergan deal, 2015 also witnessed eye-watering deals such as big-time brewer AB INBev’s US$117b bid for rival SAB Miller, Shell’s US$81.5b purchase of UK energy supplier BG and the US$78b deal between Charter Communication and Time Warner Cable.

And according to a November 2015 survey on the subject of megadeals by RR Donnelley, the big money M&A trend is set to continue. Nearly 90% of respondents believed that the number of deals valued at more than US$10b would rise next year, with nearly half of those saying it would rise significantly. Respondents stated that low financing costs and tax/operational efficiencies would be the main drivers of megadeals in 2016.

Away from the blockbusters, EY’s latest Capital Confidence Barometer (CCB) reveals that companies across the business spectrum are upbeat about deal prospects as we enter a new year. Indeed, four of five executives (83%) expect activity to increase. And many of those have packed pipelines, with 55% of corporates now having three or more deals under consideration.

Meanwhile, despite the competitive M&A market, the CCB also revealed that executives are being more rigorous around deals. Almost three quarters (73%) have walked away from deals because they were aligned with strategy.

“Executives are taking a long-term view ... This is not ‘a deals for deals’ sake mentality.”

“Executives are taking a long-term view and evaluating deals more carefully than ever before. They are stepping back when necessary. This is not ‘a deals for deals’ sake mentality,’” said Pip McCrostie, EY Global Vice Chair, Transaction Advisory Services.

With all those factors in mind, while 2015 was the year that the M&A force awakened, there is new hope for a prosperous 2016.

Future of health care

It’s hard to open a newspaper these days without seeing another megadeal in the life sciences sector. While consolidation and inversion have been driving M&A this year, the future could very well be personalized medicine. According to a new report Life Lines from law firm Reed Smith, 70% of companies are looking to make an acquisition in this space.

Leaks blocked

The percentage of leaked M&A deals has fallen to its lowest level in six years, according to new research from technology provider Intralinks and Cass Business School. A survey of more than 4,400 deals found that just 6% of transactions in 2014 involved a prior leak, compared to 8.8% in 2013.

Bonds booming

The M&A market surge has pushed US corporate bond issuance past the US$1t mark, according to Dealogic. High-grade issuance, M&A-related activity and megadeals have all contributed to the increase. Anheuser-Busch, AT&T and Actavis all made multi-billion dollar issuances in 2015.

Investing in digital

A new survey from law firm White & Case, The cutting edge, has found that 93% of businesses in life sciences and technology sectors say digital health plays a key role in their overall business strategy. Meanwhile, 92% and 96% of life sciences and tech firms, respectively, intend to increase their investment.
CFOs turn focus to strategy

The CFO’s role is becoming more complex, with business strategy increasingly forming part of the finance leader’s remit. A Singapore-based forum, held by EY and the Financial Times, attended by 80 CFOs, academics and thought leaders, explored the evolution of this important C-suite role and how CFOs can develop strategies to steer their organizations to future profit and long-term growth. The forum discussed important changes in the role of the CFO such as a shift in focus from cost management to value creation – closing the gap between CFOs and non-CFOs as a more strategic role is assumed. Recent EY report Partnering for performance, Part 5: the CFO and CEO backs this up, with 76% of CFOs reporting greater involvement in corporate strategy in the past three years, driven by a focus on growth.

Cyber-smart M&A

With the increasing use of technology in M&A, the cyber threat that surrounds deals is heightened. EY’s Rahavendra Rao and Tim Haynes work specifically in pre-acquisition technology due diligence and have seen an increase in cyber issues faced by clients. Some of the more common issues they see their clients face include:

- Lack of cybersecurity associated with implanted malware or intrusion prevention and detection
- Payment card industry compliance as businesses are doing more payment card processing
- US federal Health Insurance Portability and Accountability Act compliance when companies are unaware of their subjectability to the regulations
- Appropriate maintenance and use of Open Source Code; improper use can lead to the loss of intellectual property, or leave the company vulnerable.

Visit capitalinsights.ey.com for tips and advice from Rao and Haynes of how these important cyber issues can be addressed.

Indian summer

India will be the most attractive investment destination in the world for the next three years, according to results of an EY survey. Nearly a third of the 505 respondents named India as the leading investment destination ahead of China (15%), Southeast Asia (12%) and Brazil (5%).

India’s macroeconomic and political stability, FDI Policy and ease of doing business were highlighted as being more attractive now than in 2015. More than three out of five respondents said they planned to invest in the country over the next year, with the majority (62%) focusing on manufacturing.

This optimism is already clear in the market, with the value of deals involving India up 18% year-on-year at the end of the third quarter of 2015.

“Cross-border transactions were a significant driver of M&A activity,” said Amit Khandelwal, Partner and National Director, Transaction Advisory Services, EY. “This reflects increased business confidence of global players in the Indian economy.”
A YEAR IN REVIEW: M&A 2015

The mega-deal M&A trend which gathered speed in 2014 accelerated further in 2015 as the number of $10b+ hit new heights. Capital Insights takes a look back at what became a record-breaking year.

The figure above shows the top five sectors and regions in terms of dealmaking value and volume in 2015. For example, the US was the top region for both value and volume this year, while tech produced the highest value and industrials and chemicals the highest volume in terms of sectors.
Top 5 M&A deals announced 2015 by value

1. **Pharma, medical & biotech**
   - Allergan plc
   - Pfizer Inc.

2. **Consumer**
   - SABMiller plc
   - Anheuser-Busch InBev NV

3. **Oil & Gas**
   - BG Group Plc
   - Royal Dutch Shell Plc

4. **TMT**
   - Time Warner Cable Inc.
   - Charter Communications, Inc.

5. **Industrials & chemicals**
   - The Dow Chemical Company
   - E. I. du Pont de Nemours and Company

Top 5 tech deals announced 2015 by value

1. **Hewlett-Packard Enterprise Company**
   - (Shareholders)

2. **Broadcom Corporation**
   - Avago Technologies Ltd

3. **Sandisk Corporation**
   - Western Digital Corporation

4. **Freescale Semiconductor Inc**
   - NXP Semiconductors N.V.

5. **Altera Corporation**

Top 5 tech acquirers 2015 by volume

1. **Alibaba**

2. **Cisco Systems**

3. **IBM (incl IBM Watson)*

4. **SunEdison**

5. **Microsoft**

Top 5 PMB acquirers 2015 by volume

1. **Valeant Pharmaceuticals International**

2. **Medtronic**

3. **Eurofins Scientific**

4. **Roche**

5. **Partnerships in Care**

The figure above shows the top five sectors and regions in terms of dealmaking value and volume in 2015. For example, the US was the top region for both value and volume this year, while tech produced the highest value and industrials and chemicals the highest volume in terms of sectors.
M&A activity in 2015 will be remembered for a host of reasons. The gathering pace of activity and major deals announced saw M&A repeatedly grab the headlines. The search for growth amidst divergent global economic conditions and technology-led disruption across many sectors provided a catalyst for deals. With that context, many companies opted for inorganic M&A as part of their growth strategies.

Breaking new ground
Some of the figures from this landmark year broke new ground in terms of size and quantities. The results for global M&A activity in H1 2015, for instance, continued the pace set in 2014. With US$2.27t worth of transactions, it was the second-highest overall deal value for a first half of the year – just shy of the all-time first-half high of US$2.59t set in 2007.

The pace didn’t drop in the second half of the year and 2015 finished with the highest-value M&A statistics on record. And there are many reasons to believe this level of activity can be sustained. More than 50% of global executives surveyed for the Global Capital Confidence Barometer’s 13th edition are planning to pursue acquisitions in the next 12 months.

“M&A is firmly back on the agenda in terms of realizing rapid and sizable growth,” says Steve Krouskos, EY’s Deputy Global Vice Chair. “Following a prolonged period of relative inactivity, 2014 and 2015 saw a clear change in focus driven by sector convergence, massive technology change and seismic shifts in consumer preferences. Also, divergent economic conditions continue to support cross-border M&A activity as companies look beyond their own borders for growth.”

Sector specifics
In terms of the quantity of deals, the second quarter of 2015 led the way with 4,281 decisive handshakes. By the start of the final quarter, more than 12,000 agreements had been signed. The industrial and chemicals sector was highly active with 2,436 deals by the start of the fourth quarter followed by technology, media and telecommunications (TMT) with 2,361. These positions were reversed, however, when value became the determining factor. Despite its impressive tally, the value of industrial and chemicals deals reached US$313b while technology, media and telecommunications value nearly doubled that with US$583b.

“In this current market, we are seeing all sectors becoming involved in dealmaking,” says Krouskos. “Certainly within technology and health care, deal values have been increasing over the past few years, but we have also seen increased activity across all industries. It is obviously difficult to say, but the momentum built up over 2015 would suggest high-value deal activity should continue well into 2016.” He continues: “The resilient confidence in the global economy coupled with favorable interest rates and greater corporate earnings has created an environment in which companies are confident enough to make bold M&A moves. However, the one unknown is global security concerns, which could moderate activity in 2016.”

Go west
The US led the M&A way, both in terms of volume and value. With 3,734 deals completed to the tune of US$1.6 trillion, activity in the US outstripped the nearest countries by a large margin. China with 1,277 deals worth US$295b and the UK with 1,077 deals had a combined value of US$263b.

In terms of emerging markets, South Korea was very active, with 264 deals worth US$75 billion. These results support forecasts that South Korea, with amended regulations designed to enable future M&A, may become a greater deal force to be reckoned with in the future. Already, early-stage M&A activity in South Korea is up 42% and is well above the Asia-Pacific average.

“America’s aggregate deal value in Q2 15 more than doubled year on year,” notes Krouskos. “Not surprisingly M&A from this part of the world had a major influence on the global deal economy in 2015.”

Headline deals
The significance of this year’s megadeals had a telling influence on the overall 2015 figures. Six months in, the number of deals exceeding US$10b had surpassed the previous half-year record reached in 2006. With 31 deals
M&A is firmly back on the agenda in terms of realizing rapid and sizable growth."

M&A on a high
Bumper year breaks all records

It was a blockbuster year for M&A in 2015, with US$3.8t worth of deals announced and record-breaking deals in sectors including food and beverages, life sciences and oil and gas, according to Mergermarket figures. A record 67 deals with a value of more than US$10b were agreed, worth a total of US$1.86t according to Dealogic data – more than double the 2014 total of US$804.4b. While volume maintained a steady increase from 2011–14, with a slight drop in 2015, values have continued to skyrocket in a straight upward curve since 2013. This reflects a renewed global financial confidence and signaling recovery from the Global Financial Crisis of 2007–8.

"M&A is firmly back on the agenda in terms of realizing rapid and sizable growth."

For cable-telecommunications giant Charter Communications, the basis for its US$78b merger with Time Warner Cable (TWC) and Bright House Networks (BHN) was to foster competition, develop economic synergies and realize technological innovation. Tom Rutledge, President and CEO of Charter Communications says: "With our larger reach, we will be able to accelerate the deployment of faster internet speeds, state-of-the-art video experiences, and fully-featured voice products, at highly competitive prices."

In a sector where technological possibilities had shifted fundamentally in less than five years, teaming up with partners that add scale and specific expertise provided Charter with the means to make a commanding move.
“This combination will only accelerate the great operating momentum we’ve seen over the last year and provide enormous opportunities,” said Robert Marcus, Chairman and Chief Executive Officer of Time Warner Cable.

High on the leading 2015 M&A transactions list was the coming together of Dell and EMC. Announced in October, this historic contract created the world’s largest privately-controlled, integrated technology company in a deal worth US$63b – one of the largest tech acquisitions ever.

“The combination of Dell and EMC creates an enterprise solutions powerhouse,” said Michael Dell, the Founder, Chairman and Chief Executive Officer of Dell.

“Our new company will be exceptionally well positioned for growth in the most strategic areas of next generation IT including digital transformation, software-defined data centers, converged infrastructure, hybrid cloud, mobile and security.”

**Tech savvy**

Like many of the trending mega deals that reached values well above the US$10b-mark, the new Dell and EMC amalgamation is about elevating the business to the next level. That aspiration is prevalent across many tech mergers which have been among some of the biggest deals reached in 2015. These tech deals illustrate a multi-faceted, influential and fast-moving sector that is not only growing in stature but has also recorded a huge value spike in 2015. With the aggregate quarterly value hitting US$127.2b, Q2 was the highest quarter since 2000. This is an increase of 65% sequentially and 142% year-over-year.

“Disruptive technology and cross-industry blur will prompt more megadeals,” says Krouskos. “These enormous collaborations bring together end-to-end solutions which in turn satisfy the demand for Internet of Things (IoT) devices, continued smart mobility expansion and the need for secure, high-performance cloud data centers. The tech industry is transforming, and mergers will continue to be part of this rapid growth story.”

**Facing the future**

Looking toward 2016, there will be numerous challenges for dealmakers to overcome: volatility in commodities and currencies, swings in equity markets and moderating growth in key emerging economies pose questions. Yet despite these issues, executives are looking to M&A for answers with a sense of confidence. According to EY’s most recent *Global Capital Confidence Barometer*, the number of executives planning to pursue acquisitions remains above the long-term average as 59% of companies acknowledge that they intend to pursue purchases in the next 12 months. There is also maturity in the market with 73% admitting they have either failed to complete or cancelled a planned acquisition during the past 12 months. “The big difference between this market and previous M&A booms is its prudence,” says Krouskos.

“Executives will only commit to deals if there is a strong strategic rationale to do so. If there is not, they will walk away. Buyers are also willing to reconsider their approach if they feel they are paying over the odds. Although there is an obvious air of caution, M&A is firmly back and is being used as a strategic route to growth.”

For further insight, please email editor@capitalinsights.info
What is your take on the M&A year in 2015 — why has it been so strong?

Boardroom confidence, cash balances and a mixture of consolidation and convergence have driven the market on. Megadeals have obviously hit the headlines and technology has been at the forefront of many of these but a broad range of industries have seen deal activity. This is despite the fact we have had so much turmoil in the marketplace — changes in commodity prices, foreign exchange rates, political unrest around the world, varying growth in different economies could all have derailed the market. However, we’ve seen a market so robust that it has set new records that have exceeded any year since the financial crisis.

Looking ahead to 2016 — do you believe that the M&A momentum can be maintained?

I think that the momentum from 2015 is likely to carry over into 2016. Some experts and advisors are saying dealmakers will be more selective with their deals next year. However, on the other hand, there are those in the market that are predicting that next year will be at least as good as this year, or even up. My own viewpoint is that it won’t change much from where we are today. That could be plus or minus 10%. However, if you look at 10% off what will be a record year that would still make 2016 a very good year for M&A. At that level, 2016 will be one of the top two or three years ever. Based on what we know today, one can be very bullish about 2016.

What are the challenges that could potentially derail M&A in 2016?

There is one major challenge that could put a dent in the M&A market this year. There is still a huge amount of uncertainty surrounding the very critical geopolitical situation in the Middle East. If that region escalates into war or uncontained terrorism so that the economic markets are effected as well, things could be very different. There is also the global reaction to interest rate rises to be considered and the impact on the bond market and what that means for foreign exchanges and emerging economies. This could temper any rising confidence we are currently seeing.
Extreme risks call for Xtreme measures

As part of Capital Insights’ cyber focus, we invited Phyllis Newhouse, Founder and CEO of Xtreme Solutions, to talk cyber risk and the state of IT.

In today’s digital and technologically integrated world, cybersecurity is the number-one business priority. Xtreme Solutions Inc. has been at the forefront of cybersecurity innovation for more than a decade. The Atlanta-based company was co-founded by Phyllis Newhouse in 2002, following 22 years of military service with the US Army, where she served as a Senior Non-Commissioned Officer working on many assignments within the Department of Defense.

Within the first year of business, it had landed its first IT contract, with AT&T. Xtreme added other Fortune 100 companies as customers before winning over several million dollar federal contracts. And thirteen years later, the level of cyber risk and rate of technological development is even greater than Newhouse had anticipated.

Newhouse discusses how these changes have impacted her company’s strategy, and what lies ahead for the IT and cybersecurity sector.

What is the state of the IT services industry and how has it changed in the past five years? The IT industry has [experienced] three key changes. Firstly, today’s IT business requires a very different talent pool, [because of] the evolution of technology and, in particular, the evolution of one of our focus areas – cybersecurity. What we looked for in a talent pool in cybersecurity five years ago is certainly very different from today, and it’s evolving still.

Secondly, there is the explosion in social media. If companies want the fastest, cheapest, most agile way to get their product to market, they have to consider using social media platforms as a means to introduce new products to the market. But as you engage in...

“The biggest change that I’ve seen in the past five years, as an IT industry provider, is the security considerations that you must have.”
“What we looked for in a talent pool in cybersecurity five years ago is certainly very different from today, and it’s evolving still.”

As the CEO of a successful entrepreneurial enterprise, what advice would you give to those looking to start a business – particularly one in the IT market?

Manage and assess your risk upfront. If somebody were to get a hold of whatever your intellectual property is, what would it cost you? And what would be detrimental for you as a business owner?

Make a plan. Once you’ve done that assessment, go through and develop – or get an external expert to come in and help you to develop – a cybersecurity plan.

Companies need to be aware of the latest developments. What are some of the latest developments to protect against viruses, the latest in spyware and malicious codes? Stay on top of that. Hire industry professionals to come in and do audits, and to help you look at the new trends.

Top tips

Other companies may offer you a solution, but may not have what is needed in this space now, which is the intelligence about the adversary that is trying to attack your industry or organization.

Do you anticipate further rapid change in the sector as we move into 2016?

When you look at the number and sophistication of cyber breaches today – whether it be in our government institutes or in business organizations – [there is] a rapid evolution of technology. So what I see in 2016 and beyond, is that there has got to be a level of compliance in governments and organizations, as these more sophisticated breaches and cyber attacks start to [seriously damage] our economy.

In 2016, we will also see increased focus on the importance of addressing this problem, because, ultimately, it will start to impact our critical infrastructure. Once [that happens] we’re going to have more technology companies entering the market and new business opportunities as a result of that. So I see the information security space
rapidly changing and growing, even just in the cybersecurity industry alone.

When you founded Xtreme Solutions Inc. in 2002, what were the goals and expectations for your company? How have these changed?

When the company was founded, it was with the mindset that we needed [to be] constantly innovating in order to anticipate changes in the market — particularly in cyberspace, because that was where the focus was in 2002. But we knew that innovation had to be a big part of creating solutions, and [that we had to do] it quicker than our competition.

With that in mind, we examined the different business metrics and the analytics. As those aspects grew in the market, we needed to focus on improvements in this industry and be innovation leaders.

So, from 2002, the goals and expectations of the company have changed drastically, because the market has changed. We didn't anticipate in 2002 that we would see this level of complexity of cyber attacks. But as a result of that, [we have] to be forward-thinking and to look three or four years ahead of where we are.

And so one of our goals is to align ourselves strategically with partners that have the latest products, innovations and cutting-edge technology and solutions.

What are your goals for the company in the coming year and beyond?

We're focusing our efforts on cybersecurity training. In our industry, there are not enough trained professionals, so there's a huge gap in the workforce. We're focusing on a robust training program both on-site and off-site, internally and externally, to develop the type of workforce that is going to be needed for the complex issues that we're going to have in the industry.

Our other area of focus is to develop solutions that address problems, ultimately, that affect us on a global platform, not only here in the US. So, how do we get ahead of the curve to prepare for these cyber attacks that could affect us not just here in the US, but globally?

Additionally, one of our main aims is to work with international business partners who are working on a global level.

What are some of the biggest challenges facing your clients?

One of the biggest challenges that we are seeing with our clients on a day-to-day basis is the lack of experience in IT departments. And we normally see it when a cybersecurity incident happens.

So the lack of talent, and [businesses] not really understanding what cybersecurity is. Businesses often don't have cybersecurity plans or risk mitigation plans. These are some extremely large business challenges when you talk about the average business owner – even for smaller businesses. That is really where they are struggling with this.

Large organizations have a talent issue. And stakeholders don't often understand the cybersecurity area – they haven't done thorough assessments of the risks if they were to have a breach. So those are some of the biggest challenges we see our clients facing today.

When it comes to M&A, what are the main cybersecurity challenges for your clients?

Cybersecurity breaches pose a real threat to M&A deals, and companies are too complacent in their assessments of cyber risks. We find that more than 90% of dealmakers say that their weakness is in assessing potential cyber threats. However, the cyber due diligence process is still not always being conducted.

One of the things businesses should always consider for any transaction is that there has to be a thorough cyber due diligence practice for any M&A deal. This is because there are vulnerabilities and internal and external threats that could influence the assets’ value or its future integration into your business.

“...the cyberadversaries that present the biggest threat to businesses and government agencies today.”

For further insight, please email editor@capitalinsights.info
The urge to converge

Megadeals and market consolidation have kept US M&A in the headlines in 2015. The M&A surge will continue in the face of unprecedented disruption, as companies cross sector lines in search of growth and innovation.

Four Cs — consolidation, confidence, credit and cash balances — have driven the US M&A market to new heights in 2015. US deal values rose by a staggering 55% in 2015 to a record high of US$2.3t, compared to US$1.5t in 2014.

While the top megadeals — such as AB InBev’s US$120.3b bid for SAB Miller, and Pfizer’s US$183.7b bid for Allergan — garnered most attention, there was robust activity in the upper-middle market and this is expected to continue in 2016.

According to EY’s latest Capital Confidence Barometer (CCB), released in October, some 88% of US respondents felt the M&A market would improve in the next year; none felt it would decline.

Indeed, this optimism is carried over into actual dealmaking intentions. Around three-quarters (74%) of executives are planning deals in the next year — the highest result the CCB has ever recorded.

Looking ahead to 2016, there are two more Cs to be added to the aforementioned quartet — changing consumer preferences and convergence. Changes in customer behavior lie at the core of shifting competitive dynamics across sectors. And if companies want to protect market share, they need to find a way to adapt and align with changing tastes. For many, this will mean turning to M&A for new materials, intellectual capacity or evolutionary technology.

In terms of convergence, 93% of US respondents to the CCB plan to make an acquisition outside their own sector. This will be particularly prevalent among technology companies. For example, in an industrial sector such as oil and gas, technology such as the Internet of Things can provide greater operational efficiencies at a time when oil prices are well below average.

The same is true with life sciences. As digital health care becomes more mainstream, we are likely to see more deals and partnerships between technology and life sciences businesses. Novartis’ July 2014 partnership with Google, to produce contact lenses that monitor blood-sugar levels, is just one example.

Although appetites remain high, the CCB found that executives would continue to exert caution and walk away from deals with too many risk factors. However, given the unrelenting power of disruptive forces impacting almost every industry, companies sitting on the sidelines will do so at their own peril.

This caution will see companies closely monitoring geopolitical risks and market financing going into 2016. But while financial markets continue to reward dealmaking, the US will remain a hotbed for sustainable M&A activity in the immediate term.

Richard Jeanneret
is the Americas Vice Chair of Transaction Advisory Services, EY.
Mid-market mood swings

Despite a strong start, 2015 saw an uneasy mid-cap segment fall short of expectation. With a new year upon us, can mid-market firms turn promise into reality?

The mid-market is the engine of M&A activity. Whether in the form of venture capital-backed start-ups that have matured, long-held family-owned SMEs, private stalwarts of industry or listed corporates that fly under the radar of analysts, the lion’s share of dealmaking volume is accounted for by companies with moderate revenues.

However, throughout 2015, megadeals garnered most of the attention. In the first nine months of the year, 45 deals worth US$10b or more were announced, with a combined total value of US$1.15t, according to figures from Dealogic.

Corporates are sitting on record cash reserves. Figures released in June by Standard & Poor’s showed that, at the end of 2014, a pool of nearly 2,000 US non-financial companies held a record US$1.82t in cash and short- and long-term investments, up 5% on the previous year. This mountain of money, however, is concentrated in the hands of the very largest firms. The top 1% of corporates accounted for 48% of this cash. And between them, Apple, Microsoft, Google and Pfizer were carrying a combined US$397b.

The size of this war chest resulted in 2015 becoming the biggest year for M&A on record. However, activity has been notably skewed toward the mega end of the spectrum, with transactions such as the US$78b Charter Communications and Time Warner Cable tie-up and Dell’s US$67b merger with data storage company EMC accounting for much aggregate deal value and stealing headlines.

The mid-cap segment (deals valued at between US$500m and US$2b) has been more subdued. Despite a healthy start to the year,
Middle-market M&A activity has shown signs of weakness. By the end of September, 2015 had produced 1,681 transactions, worth a combined US$208.9b. This compares with 1,768 transactions totaling US$242.8b during the same period in 2014 and represents a 5% drop by volume and a 14% drop by value.

**Mid-cap motivators**

While middle-market M&A eased off in the face of high prices and recent anxiety in capital markets, there is still reason for optimism, according to Ryan Burke, EY’s Global Middle Market Leader for Transaction Advisory Services. “Global M&A activity is at a six-year peak and has been steadily rising over the last two years,” he says. “So I see any downward trend in the middle-market, which has [traditionally] been very strong, as a slight slowing down because of how much growth there has been in recent times. In spite of the recent dip in activity, the mid-cap segment is expected to hold up in the year ahead, as market fundamentals remain strong and a number of factors drive deals.”

Burke named five key factors, including buoyant sectors, confidence, add-ons, dry powder and baby boomers that will drive the mid-market segment in 2016 (read more about these factors online at capitalinsights.ey.com).

Mark Brockway, Executive Director at EY Corporate Finance, echoes these sentiments. “The environment is still positive for M&A in terms of the latent supply of deals that are ready to be done. “Our clients are also telling us that they want to do more deals. But it’s a fact that these deals haven’t happened, or at least haven’t happened yet. And there’s one very specific reason for that: the economy. Companies have a strong appetite to transact in the mid-market, but some sellers are either holding out for a premium price, or sitting out an uncertain external market which makes their financial forecasts less certain.”

Corporates are more eager to invest than ever. According to EY’s latest Capital Confidence Barometer (CCB), 59% expect to actively pursue acquisitions over the next 12 months, the highest appetite for deals in six years. And in other good news for the mid-market sector, the CCB found that 80% of companies have either two or three deals in the pipeline and that upper-middle-market deals were expected to increase next year.

**Mid-market matters**

Over the summer, a number of warning signs put investors on the back foot. In the US, stock markets sank in their worst August for three years amid uncertainty over China’s economy and anticipation of the Fed’s interest hike. The FTSE 100 and other key European market indices also shed points.

And it is not just China’s growth that has been showing signs of weakness. The US undershot expectations when its GDP expanded by just 1.5% between July and September. Similarly, the Eurozone posted growth of only 0.3% again in Q3 after also falling short of forecasts in Q2.

“Middle-market companies see a moderation of the top line, and that begins to concern them,” says Bob Rubino, Head of Corporate Finance and Capital Markets at Citizens Commercial Bank. “Larger companies can justify higher purchase prices because they can make cost and revenue synergies. They also know what they want, because they have long-term growth strategies. And they have the means to buy because they can access international financing.

“However Q4 should be a decent quarter for growth. And confidence should return as we get...”
People are going to realize that the shock we saw in August wasn’t a harbinger of bad times to come.”

There is further reason why potential buyers may have been exercising caution, even prior to the summer wobble: valuations. The median EBITDA multiple paid by companies came in at 8.5x in Q3, higher than in any three-month period last year, according to Pitchbook data. With prices rising over the last 18 months, buyers are having to make a stronger investment case before closing deals. For corporates, this means being more diligent than ever and seeking out large-scale synergies that can justify sellers’ price expectations. Once again, this favors larger entities with greater cash reserves and more potential to cut costs.

“When prices are high you have to either accept a lower rate of return or be operationally disciplined, meaning you have to identify the synergies and realize them,” says Rubino. “In the mid-market you rarely have cost synergies. It’s the big companies that you are able to take costs out of, because they’ve become global and, often, overweight.

“In the mid-market you really have to focus on revenue synergies, where you can create a more attractive offering for existing or [prospective] clients.”

Private equity (PE) does not have the opportunity to realize synergies with new platform deals. This means many funds are currently cautious about making new deals. And they are instead focusing more heavily on bolt-on deals and on realizing existing investments from their portfolios, in today’s sellers’ market.

Of course, some industries are feeling this pricing pressure more than others. Despite this, the technology and software sector continues to be an area of focus for corporate M&A.

“The two big trends in M&A are consolidation, and technology-enabled businesses. Companies are buying technology to improve their core business,” says Brockway.

M&A in the sector continues to benefit from the transition to cloud computing and from the focus on cybersecurity following a number of high-profile data hacks, such as the breach of UK telecoms firm TalkTalk’s customer information in October. The US$635m purchase of US internet security firm OpenDNS by US technology giant Cisco, in August, covers both of these trends. Another notable deal in cloud computing closed in July, when PE firm Francisco Partners bought ClickSoftware Technologies, an Israeli-based field management software company, in a take-private deal for US$421m.

“When it comes to new deals, overall we’re cautious,” says Matt Spetzler, a London-based partner at Francisco Partners. “We’ve been second or third in sale processes on a number of occasions. And in some cases we’ve been outbid by 20% at the edge, which is crazy.

“Deal flow has slowed, there are still a lot of funds out there with money, chasing any decent businesses. That combination starts to get into squeamish territory, and that causes people to pause. A lot of the good businesses have already been sold after taking advantage of the frothy markets in the first half of the year.”

A healthy pipeline
The underlying macroeconomics of recent months may not have been as robust as the middle-market would have liked in order to transact. But there are many reasons that dealmakers can expect steady deal flow in 2016. PE has plenty of capital that it needs to put to work, even if many firms are currently cautious about how and where to invest it. Meanwhile, corporates are reporting high levels of confidence, and they continue to seek revenue-accrative acquisitions as lackluster growth persists. This means that M&A demand – and valuations – will remain high. And it also means that financial sponsors and corporates alike will be judicious in putting capital to work.

“For further insight, please email editor@capitalinsights.info

“I see any downward trend in the middle-market, which has [traditionally] been very strong, as a slight slowing down because of how much growth there has been in recent times.”
The digital megatrend is here to stay, and in EMEIA, as well as across the globe, businesses are using M&A to adapt to this new digital world.

Are businesses still underestimating the impact of digital? Probably – after all, many businesses underestimated the impact of the internet back in 1999. The vast majority of traditional businesses still lack the expertise to build in-house digital capabilities. Consequently, M&A has become a fast-track route to expanding those capabilities and growing intellectual property (IP) assets. In terms of digital, buying rather than building has many advantages.

As recurring transactors, private equity is a critical sector for M&A. PE firms are eager to hire – or acquire – people who understand the impact of digital on business and can help to better assess risk and reward in associated deals.

What those digital-savvy people know, is that some of the criteria that used to apply to target valuations and deal making is no longer applicable. New assessments need to be applied and would-be acquirers need to change the way that they formulate their M&A processes – from strategy to execution and throughout integration. This can have a significant impact on the value creation story. Are the businesses acquired at high prices over the past five years fit for this digital future? What kind of additional investment is needed to keep pace to ensure that the value on exit will not be dented?

This narrative is clearly taking shape across EMEIA. We see more and more PE houses strengthening their digital strategies, implementation and diagnostics to ensure that their portfolio and new acquisitions are aligned with digital strategies.

It is quite difficult to precisely assess the impact of digital on M&A, as the numbers are still relatively small. But it’s clear that this phenomenon is spreading fast. We are seeing more corporates and portfolio companies abandoning traditional target scouting techniques and trying to understand how competitors will respond to digital. They know that it will be a case of disrupt – or be disrupted. And that is leading to an increasing number of talent and IP-motivated acquisitions to build digital capabilities.

This is going to become the new normal. Over the next three to five years these deal trends will continue to accelerate. We will see corporate functions and business units move in the digital direction as a normal course of business.

Before long, we will no longer differentiate “digital M&A” from the norm. The digital storm will pass, but the deal landscape will have been altered forever.
IT’s all about innovation
Cisco CFO Kelly Kramer talks strong growth and ‘healthy paranoia’.

With an infectious smile and business acumen that has navigated Cisco’s finances through her first year as CFO to growth success, Kelly Kramer is the epitome of the modern multitasker.

The CFO steered the company to US$49.2b in total revenue at the end of their fiscal year 2015, and results for Q1 fiscal year 2016 were announced in November, Kramer is already bettering her own results, posting revenue of US$12.7b – an increase of 4% year-on-year.

“I feel pretty good looking back over the past year; we finished fiscal year 2015 at the end of July and announced our results for Q1 and we continue to drive profitable growth, with our earnings per share (EPS) is growing faster than top line,” Kramer says.

Back in 2012, Cisco made a commitment to shareholders to drive profitable growth – and it’s a commitment Kramer intends to maintain.

“In fiscal year 15, we grew top line by 4%, we grew 4% in Q1 and we grew EPS 7% in FY15, and were up 9% in Q1FY16. We’ve continued to be able to do that in a very tough macro environment where a lot of big multinationals haven’t. I feel pretty good about how the business is running. And also I feel pretty good about the players I have on the finance team. I’ve a great team that really helps us to support the business well.”

Not bad for her first year in the job. Kramer succeeded Frank Calderoni in November 2014, after joining Cisco in 2012, and she is quickly ticking off her list of intentions for the role.

“Cisco finance is well known for its tenet of world-class transparency, ethics and integrity and, of course, that’s obviously the base of what we will continue. However, what I wanted to bring to the party was helping the business through operational discipline and portfolio management. I wanted to see the business continue to grow and to maintain our strategy of driving profitable growth.”

With a CV that includes stints at GE, in CFO roles for the conglomerate’s health care systems business, Healthcare Biosciences and Molecular capitalinsights.ey.com | Issue 15 | Q4 2015
Diagnostics, Kramer brings to Cisco’s finance team a wisdom, insight and experience that comes from jumping at every opportunity that came her way. Her varied experience is also a shining testament to the opportunities that both finance and technology provides.

“The thing about tech, and why I was attracted to it, is that it’s so fast moving and it’s all about innovation,” she reflects. “Coming to Cisco, which is one of the older companies in tech at 30 years of age, what’s interesting is how quickly companies come and go in the sector and it is a testament to the fact that you have to innovate all the time. The one thing we know is that you have to constantly innovate to stay ahead of what’s happening, whether that’s technology shifts, new competitors every day, or new business models.”

**Keeping ahead**

In the technological cauldron that is Silicon Valley, where the 2015 Kaufmann Index reports a rate of 410 new entrepreneurs per 1,000 people per month and a start-up density of 168.3 (the number of start-ups per 100,000 people), keeping ahead of new innovations is a hard task.

“There’s always small companies that might come up with an innovative idea. We never minimize the potential for competition and disruptors, so it’s all about constantly having a healthy paranoia to make sure we’re staying abreast of what we call product transitions or market transitions,” Kramer says.

And part of this “healthy paranoia” is to ensure that innovation dollars are being invested in the right areas. Cisco's leadership regularly review innovation spend.

In November, one such session saw Kramer and her team complete a long-range planning process, with all business units laying out their research and development spends.

“It’s a healthy exercise to go through at least once a year to make sure we are spending smart for the future.”

For a multinational such as Cisco, keeping pace with future technological developments requires a multi-pronged approach.

“We do a variety of things,” Kramer explains. “Internally in our business lines and in our business units, we’ve always been constantly assessing the competition.”

In addition to these ongoing assessments, Cisco also has its own dedicated venture fund, which is part of the company’s corporate development strategy.

“We invest in the very, very early stage companies. That could be something to do with our existing product lines or it could be something in an area that we are interested in; could be a future area,” she says.

Past investments have included themes such as the Internet of Things (IoT), or analytics, before analytics was mainstream. When Cisco makes this venture fund investment, while only taking a small percentage, it also gives them board observer rights.

“This is so important because we can hear the conversation when the companies are at board meetings. It’s a good way for

“...”

**Lead from the front:**

You have to have a position, an opinion, that will help drive the business forward. That doesn’t just mean the direction of your finance team, but the business as a whole.

**Communicate clearly:**

I believe that being a clear communicator and a through thinker is critical. You have to have the ability to explain your strategy simply to your employees, investors and customers.

**CFO first:**

Always keep in mind the fundamentals of the role – driving the financial performance of the business and ensuring profitable growth.

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1984

Cisco founded by two computer scientists from Stanford University

1987

Cisco receives funding from venture capital firm Sequoia Capital

1990

Cisco goes public in February on the NASDAQ. Gains market capitalization of US$224m

The name ‘Cisco’ was derived from city name ‘San Francisco’ and the logo is intended to depict the two towers of the Golden Gate Bridge.

Capital Insights from EY Transaction Advisory Services
us to learn about new industries, perhaps acquire some of these companies. Other times they get acquired by rivals, so it's a way to get early intelligence.”

**Buying up big**

Of course, when it comes to new innovations, acquisitions can provide a quick injection of talent and intelligence — and Cisco are not shy of a deal. Having invested US$70b in more than 180 acquisitions, M&A has become a core part of the Cisco growth story.

“Besides the venture fund, we are constantly doing acquisitions,” Kramer says. Indeed, during the first quarter of fiscal year 2016 (July – October 2015) Cisco completed acquisitions of OpenDNS, MaintenanceNet, and Pawaa Software to further complement its security, services, software, and cloud offerings. These purchases aim to build on the company’s strategy to increase innovation and R&D investment in growth areas such as security and video technologies. Cisco also recently announced the acquisitions of Portcullis, ParStream, Lancope (US$542.2m), 1 Mainstream and Acano Ltd (US$700m) in the security, data analytics and video areas, all of which are expected to close in the second quarter of fiscal 2016.

“It could be anything from a US$2b acquisition of a company such as [Wi-Fi start-up] Meraki, or it could be what we call ‘tech and talent’ acquisitions. Those might be very small private companies that could have anywhere from five to 30 employees that have a certain expertise in an area of interest. We will go out and buy a lot of those and just incorporate them into our technology teams. That way we have a lot of different avenues to get in front of the technology trends.”

The M&A team is a well-oiled machine. There is a member of the team assigned to each business line area to work with the business units, constantly assessing that field and what targets may best fit. This assessment includes culture, strategy, integration challenges and valuations. “It’s a very disciplined and vigorous process. We have a world-class business development team that helps us do this.”

Due to the sheer volume of acquisitions the company makes, Cisco has a permanent integration team who works full-time on ensuring the smooth merger of newly purchased companies. “We have a couple hundred people who are full-time on integration, and that’s across all functions. So, for example, a separate team for finance integration, or engineering integration.”

**Early integration issues**

However, it hasn’t always been an easy process for Cisco — like many other companies, there has been trial and error in finding an acquisition and integration process that works.

“In the early days, when we started to go in these other adjacent areas, we might find that selling software is different from selling a boxed service. We found that you couldn’t just push everything through the same sales system. We learned that the hard way the first time.”

Once a transaction is completed and integrated however, that is not the end of the story: quarterly assessments track how the acquisition is performing against goals set at the beginning of the process.

Acquisitions are just one of Cisco’s five strategic goals of buy, build, partner, co-develop and equity investment.

Storage is one area in which a partnering strategy comes into play. Partnerships with EMC or Netapp have lead to storage app architecture for the market.

Cisco also announced a partnership with Ericsson which gives access to new geographies and also opportunity for co-development on IoT products and more.

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**Kelly Kramer CV**

Senior Vice President and Chief Financial Officer, Cisco

**Age:** 48

**CFO since:** January 2015

**Educated:** Bachelor of Science degree in mathematics from Purdue University

**Previous positions:** Senior Vice President of Corporate Finance, Cisco; Vice President and Chief Financial Officer of GE Healthcare’s Healthcare Systems business; CFO of GE Healthcare Biosciences, a division in Life Sciences and Molecular Diagnostics

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**1993**
Cisco makes its first acquisition — Crescendo Communications — and its 100-Mbps Copper Distributed Data Interface technology

**1995**
Cisco makes further acquisitions in the form of Combinet, Internet Junction, Grand Junction and Network Translation

**1998**
Cisco becomes the first company to achieve market capitalization of US$100b in 14 years and performs nine further acquisitions
This idea of co-development was a new strategic aim introduced in Chuck Robbins’ first months as CEO to work with customers to ensure they are building fit-for-purpose products. Robbins also brought with him the idea of equity investment — the venture arm of the strategy to help seek out new technology, talent and innovations, which Kramer feels is hugely important to the growth of the business. However, it is not only innovation by competitors that has Kramer in the aforementioned state of ‘healthy paranoia’, but also innovation by adversaries. With the number, frequency and sophistication of cyber attacks on the increase, cybersecurity is a number one priority for Cisco. But not only is it a challenge, Kramer explains that as leaders in cybersecurity, “it is also a huge opportunity for us as well.” The CFO also sees a great deal of opportunity in cloud computing as “we’re the world’s largest infrastructure to cloud providers as well.” However, the company and Kramer herself are not resting on their laurels. “You have to be constantly moving forward and getting ahead of what trends are out there because they change fast,” she says.

**Race for tech and race for talent**

It is not just the latest innovations that spark a flurry of activity for companies such as Cisco, but also the quest for talent. Kramer is a firm believer in the value of her workforce, and Cisco has no hesitation in investing for their future leaders. “It is a race to get the best technology talent, the best engineering talent,” she explains. “We are fighting with the Facebooks and the Googles of this world.”

To make the company more attractive to prospective talents, Cisco have devised a series of internal start-ups called ‘Alpha projects’ to foster entrepreneurial creativity and innovation. “We hire someone from the outside, give them a charter and get them to build a team and a plan of what they are going to deliver,” she explains.

**Empowering women in tech**

Technology is often seen as a man’s world, but Cisco’s pioneering CFO is looking to change those perceptions.

In the technology sector, men outnumber women seven to three, according to a report by New York-based economic development consulting firm HR&A Advisors.

Cisco is very aware of the diversity statistics for its industry, and is taking strides to make a difference. Five out of 13 members of the CEO operating committee are women, and three in 10 board directors are also women.

Kelly Kramer explains the rationale behind her company’s push to raise the awareness of tech as a career choice for young girls and attempt to close the gender gap in tech.

“I was a math major and I’m a huge believer in the STEM (science, technology, engineering and mathematics) studies. And I’m also a mother. I’m encouraging my daughter, who is still in high school, to go down the engineering or math route.

I think if we’re ever going to change the ratios in tech of the male to female, we need to have more girls coming into the funnel at young ages. We need to have more programs to develop them and more role models, so women can see how they can have a role in the technology industry.

We have a lot of programs. JUMP is one specifically aimed at junior level women only. It’s a great way for them to get leadership training and development with their female peers. We have a lot of these events and it’s part of our long-term strategy … we’re making progress, but we’ve got to move faster.”

In total, Cisco has been issued more than 12,200 patents.

In 2000 Cisco becomes the world’s most valuable company in terms of market capitalization (US$569b).

In 2004 Cisco invests US$32m in a Chinese research and development center. The company also pledges US$50m to help Korean SMEs adopt and deploy networking technologies.

In 2006 Cisco announces plans to invest over US$265m in Saudi Arabia and US$275m in Turkey over the next five years.

Cisco has acquired more than 150 companies.
These projects operate outside of the Cisco bureaucracy. Their pay is different: on high-risk, high-reward performance-based pay structures which encourages an entrepreneurial mindset. “Those have been pretty successful for us.”

Kramer says the investments in both attracting and retaining talent – including recent office redesigns and incentives such as bringing pets to work – are no different to their other R&D investments. “It is an investment that has a high return by being able to attract the right talent – and that’s very important for us,” she says.

This is just one of many competing uses of capital that Kramer must negotiate. The US$1.2b in cash flows that Cisco generates on average each year does make those considerations slightly easier however. “We are blessed with awesome cash flow,” Kramer admits. In fiscal year 15, the capital allocation strategy promised 50% of free cash flow would go back to the shareholders. Cisco also put a dividend in place and operates a structured share buyback program, both of which have been popular with investors. Then, of course, there is plenty of cash left for the large pipeline of strategic acquisitions.

Keeping track of many moving parts
Kramer has her hands full. With numerous products and projects, Cisco is made up by a variety of business models. The core model for Cisco, Kramer explains, is a simple sell product, which will have services attached. Cisco also has one of the largest enterprise software as a service (SaaS) companies in their WebEx business, which was acquired for US$3.2b in 2007. “And then we have a large service business, and more and more we’re making a shift into more software and recurring revenue,” she says.

Customers are also looking for different ways to consume products, so Kramer has teams working on different kinds of consumption models based on what customers want.

“They may want a software enterprise license that allows them to access different features and functionalities and have the technology protection over time or they may want to consume our network as a service – more like a rental,” Kramer explains. “What’s good about our balance sheet is that we have a lot of flexibility to be able to provide that for our customers depending on what works for them.”

Sharing the success into the future
At the November announcement of Q1 results, Kramer told shareholders: “Despite a challenging environment, we are executing very well and making the right investments that position us for future growth. We are continuing our commitment to shareholders as we returned $2.3 billion of our free cash flow back through dividends and share repurchases in Q1.”

As we move into 2016 – this is precisely the kind of speech that Kramer hopes to make again. “First and foremost, we will continue driving top and bottom line growth for shareholders and customers,” she says. “Partnering with [CEO] Chuck [Robbins] and the leadership team, we can get those decisions right – moving fast on products and fast on acquisitions.”

“Our approach has always been to break our company up into three constituents: employees, customers and shareholders, and they are all extremely important,” she explains. “If I think about investors, you need to listen to your investors, you need to know what they want. If I look at our investor base, it’s shifted from 30 years ago when we started as a new internet company and we had a lot of growth investors. Our base shifted to having many more value investors who had different desires from the company. They wanted a dividend, they wanted more modest-sized M&A.”

However, looking into the new year, there are no signs of an investment slowdown for Cisco. “We’re making a shift as a company to being more software-focused and having more predictable recurring revenue stream, so a lot of the new acquisition companies we announced recently are in that new model,” she says. “We’ve had over 36% growth in our software subscription business in the last quarter. That will continue to benefit from the partnerships or acquisitions that we’ve announced and we are aggressively going after these areas where we see growth and we will continue to do that. Of course, also delivering profits with that.”

A mother, mentor, role model and CFO – Kramer manages to cram it all into each day – and all with a smile.
The pace of dealmaking across the tech, media, entertainment and health sectors continues to accelerate. What’s driving the convergence trend – and where’s it heading?

The scene was set for the convergence trend in 2014, with cross-sector deals in technology, media and entertainment (TME) amounting to US$34.5b, an increase of 11% over 2013, according to Mergermarket data. Deal volume spiked 52% year-on-year to 326 deals in 2014. The trend shows no signs of slowing.

According to EY’s Capital Confidence Barometer, 48% of companies planning an acquisition are looking to purchase assets outside their own sectors. Mergermarket research shows that technology M&A is well on its way to reaching its highest annual value on record, with deals reaching US$198.3b in the first half of 2015.

Driven by rapid technological change and the battle for customers, organizations are fighting to stand out from their peers. Cross-sector convergence – expanding beyond traditional core activities to acquire new capabilities – is one way to get ahead. This is becoming rife as sectors become more digital and traditional boundaries are broken down.

According to a report by Reed Smith and Mergermarket – Wired up: the convergence of technology, media and entertainment – technology targets accounted for the largest share of TME convergence volumes (48%) and value (41%) in 2014–15.

Convergence in TME is being spurred by a number of factors. One is the explosion of devices, connectivity and content. Businesses are scrambling for a competitive edge as consumers seize the digital opportunity.

Continued buoyancy in debt and equity markets also helps, as does an abundance of cash. Other sectors are starting to join the trend, thanks to the rise of technologies such as the Internet of Things. This bridges the gap between the virtual world and the real world of hard assets, boosting efficiency and cutting time. “Sectors such as manufacturing, oil and gas, power and utilities all have potential for tech convergence,” says EY’s Global Innovation and Strategy Leader, David Jensen.

Healthy, wealthy and wise

Health care is one arena in which tech convergence could deliver a dividend. The sector enjoyed intense M&A activity throughout 2015, with a slew of megadeals as payers and providers race to boost scale and cut costs.

The rush to consolidate has plunged the US health insurance sector into a dealmaking frenzy. Among these are Anthem’s US$48.4b purchase of Cigna and Aetna’s US$34b bid for Humana.

Hospitals are also dealmaking. Major transactions include Barnabas Health and Robert Wood...
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content-based best practices to ensure the interventions you select are actionable and relevant. And you need people who know how to make the interventions work.”

Global technology giants are also getting in on the convergence act. “We've seen some of the large traditional technology incumbents make acquisitions in the health care space,” notes Jeff Liu, EY’s Global Sector Head of Technology. “Convergence is actually happening quite quickly.”

IBM highlights this trend with its 2015 acquisitions, which included health care intelligence cloud company Explorys, and integrated population health management software provider Phytel. IBM also acquired Merge Healthcare in a US$1b deal.

“Health care will be one of IBM's biggest growth areas over the next 10 years, which is why we are making a major investment to drive industry transformation and facilitate a higher quality of care,” says John Kelly, Senior Vice President, IBM Research and Solutions Portfolio.

IBM’s acquisitions build on its cognitive computing platform, Watson, which is being extended into the health care arena. IBM’s Watson Health Cloud will provide a platform for physicians, researchers, insurers and companies focused on health and wellness solutions. Explorys and Phytel will become part of IBM’s Watson Health Cloud. Explorys has one of the largest health care databases.

Gigabyte insight
IBM also acquired imaging specialists Merge Healthcare in a deal worth US$1b.

Aetna’s agreement to buy Humana for US$34.1b.

Johnson Health System combining their 11 hospitals to form New Jersey’s largest health system.

And there are growing signs of vertical integration within health care, a point underlined by the acquisition of US Health and Life Insurance by a subsidiary of Ascension Health for US$500m.

Health care is also seeing significant technological convergence. From fitness apps to smart medical devices, the use of big data to steer treatments – and drive down costs – will redraw the health care map.

Recognition that an injection of analytics boosts performance is highlighted by the US$100m partnership between not-for-profit Allina Health and data warehousing and analytics company Health Catalyst.

“Allina Health was one of the first health care organizations in the nation to recognize the need for a data-driven culture and infrastructure to enable outcomes improvement,” says Dan Burton, Chief Executive Officer of Health Catalyst. “They recognized that transformational quality improvement requires more than great software – you also need content-based best practices to ensure the interventions you select are actionable and relevant. And you need people who know how to make the interventions work.”

Global technology giants are also getting in on the convergence act. “We’ve seen some of the large traditional technology incumbents make acquisitions in the health care space,” notes Jeff Liu, EY’s Global Sector Head of Technology. “Convergence is actually happening quite quickly.”

IBM highlights this trend with its 2015 acquisitions, which included health care intelligence cloud company Explorys, and integrated population health management software provider Phytel. IBM also acquired Merge Healthcare in a US$1b deal.

“Health care will be one of IBM's biggest growth areas over the next 10 years, which is why we are making a major investment to drive industry transformation and facilitate a higher quality of care,” says John Kelly, Senior Vice President, IBM Research and Solutions Portfolio.

Gigabyte insight
IBM’s acquisitions build on its cognitive computing platform, Watson, which is being extended into the health care arena. IBM’s Watson Health Cloud will provide a platform for physicians, researchers, insurers and companies focused on health and wellness solutions. Explorys and Phytel will become part of IBM’s Watson Health Cloud. Explorys has one of the largest health care databases.

“One major challenge for cross-sector acquirers is understanding a new area of business ... This can be a steep learning curve.”
Convergence in technology and health care will be shaped by the battle for customer experience. In terms of M&A, we will see a lot of activity dedicated to perfecting the customer experience. Health care companies will try to buy tech firms to build a customer experience capability, while tech firms seek to buy health care companies to build credibility and reach.

Trust is the most important factor. Health care companies think that people associate with trustworthiness. In the digital world, however, it’s not only medical competence that builds trust, but also the ability to convince people that you can protect their data and provide the right services. My opinion is that technology companies are better positioned than health care companies for customer interface. The way in which the customer experience is delivered is unlikely to be through vertical integration. I suggest that it will be produced by an ecosystem of companies, led by the company that wins the customer interface.

Success will depend on companies being able to manage ecosystems in which “value exchange” is negotiated between different partners. This requires a significant mindset change. The underlying mechanism is driven by technology, data and reach. In such partnerships, value is represented by social exchange, not simply the exchange of money.

What is the potential for value exchange between health care and tech? Health care brings competence in terms of diagnosis, for example, while a tech company offers delivery, reach and data protection.

Apportioning value is not simple. It will be the company that owns the customer relationship that will win the largest share of revenue. The goal for such businesses will be to build scale and bargaining power.

Dr Gianvito Lanzolla is Professor of Strategic Leadership at the Cass Business School

Avoiding pitfalls
As with TME, underlying convergence drivers in health include the explosion of digital connectivity and the need to build scale. Where tech-health convergence differs is in the highly regulated and sensitive nature of the data involved. The barriers to entry are high.

There are also practical hurdles as companies venture into unfamiliar territory with lessons for all converging sectors. “One major challenge for cross-sector acquirers is understanding a new business area,” says Gregor Pryor, a Partner at Reed Smith. “This can be a steep learning curve.”

Credibility is another factor, Liu warns: “Without specific domain expertise, it may be difficult to gain a market presence no matter how good your technical solution.”

Where next?
As businesses across sectors race to capitalize on the digital opportunity, analysts are bullish about the prospects for technology convergence in 2016 and beyond.

“We are at an inflexion point in terms of the penetration of data and digital technology in our lives,” says Jensen. “If you look at health, there are unlimited opportunities for tech players to create an ecosystem around helping the end consumer.”

Successful dealmaking in the converged world hinges on cross-sector partnerships. “It’s not a sector where a single vendor holds captive all the solutions through M&A,” says Liu. “Consortia or partnering is going to become a prevalent manner of dealmaking in addition to pure M&A.”

For further insight, please email editor@capitalinsights.info
Technology is transforming the way M&A deals are done. But how can companies best manage its use?

Globally, merger and acquisition (M&A) rates continue to soar. In 2015, global M&A reached a total value of US$3.8 trillion with record-breaking deals in multiple sectors, according to Mergermarket figures.

There are a variety of reasons for this – some are strategic, such as consolidation within sectors and the search for cross-border growth. Others are financial, with debt remaining cheap and corporate coffers still bulging. Then, there is the current wave of confidence across boardrooms, aligned to the growing threat of shareholder activists.

However, technological innovation at the transaction level is also helping to spur the market. Online applications, such as IBM’s M&A Accelerator are allowing dealmakers to manage transactions more efficiently. Tools such as EY’s Cyber Econ make due diligence more thorough and big data and social media analytics mean that dealmakers have access to more information on targets than ever before.

“We’re just starting to apply analytics in a more robust way to look at assets and really understand what’s going on with the asset that’s being traded,” says Simon Pearson, Partner – TMT Corporate Finance, EY.

The digital deal table

Technology now permeates almost every facet of the dealmaking process. Before the deal begins, businesses use technology to target and research companies for M&A. “One of the smarter ways I’m seeing technology being used is around background checking,” says Pearson. “This makes it possible to check indicators such as...
reputation, employee engagement and supply chain relationships.”

Social media monitoring and analytics tools play an important part in filling in background detail. These tap into social media, such as Facebook, Twitter and blogs, to provide insights into company and customer sentiment.

Tools of this sort can be used throughout the M&A process: when sourcing deals, for example, they allow buyers to rank sentiment across potential targets. The same technology makes it possible to monitor investor sentiment during due diligence.

These platforms also provide a way for buyers and sellers to meet. “Capital sources that are looking for specific kinds of deals can now connect with parties that are marketing such transactions,” says Richard Lukaj, Senior Managing Director at Bank Street Group.

Matchmaking services, which link buyers and sellers, are becoming more sophisticated. Advanced players in this field now offer one-stop shops for M&A. For example, corporate M&A departments and private equity investors can use IntraLinks to source deal opportunities via a secure, members-only network.

“Successful dealmaking comes down to finding the right deal at the right time, and then getting those deals done quickly,” says Anthony Hill, Director of IntraLinks Dealnexus. “Surpassing the 7,000 firm mark shows that online deal sourcing is delivering on this promise, facilitating companies’ overall M&A process.”

Virtual data rooms (VDRs) are a case in point. These provide secure access to sensitive documentation (online) during the due diligence process. Less need for trips to far-flung cities, expands the pool of potential cross-border buyers.

In an increasingly global market, the ability to access documents 24 hours a day, seven days a week is vital. VDRs meet this need: “Our mission is to make life easier for M&A bankers who have to do work no matter where or when,” says Sam Riley, Chief Executive of M&A data room specialists ansarada.

VDRs are now a mainstream technology in M&A: a 2014 report published by IBISWorld indicated that there were more than 240 Virtual data rooms providers in the US, with the market growing by 16.7% a year from 2009 to 2014. Companies offering VDR services include ansarada, Citrix, HighQ, IntraLinks and SecureDocs.

Sellers can use VDRs to their advantage, such as monitoring buyer interest via audit logs: “In many cases, counterparties can actually see who’s accessed the data room,” says Jeff Liu, EY’s Global Sector Head of Technology. “Sometimes, you can manage the entrance to a data room to give the appearance of a hotly contested auction process. Equally, it could also give you data that there’s not much happening in terms of how much activity there is.”

On the other hand, the additional competition made possible by VDRs can push up the final price of an asset. Some consider the risk of errors rises when information is read on screen rather than paper. And remote access to documents means no one can be sure who’s actually reading them, although this risk can be reduced by giving only serious buyers access to the most sensitive data.

Collaboration and workflow tools also help to transform the efficiency of M&A activities. “Collaboration tools offer significant benefits in areas around contracts and documentation,” says Pearson. These tools allow multiple users to share and work on documents. Many also incorporate powerful administrative and process management functions.

The big data advantage

Access to increasing amounts of data is another game changer. IBM estimates that the world creates around 2.5 exabytes of data every day. The mix includes not only conventional “structured” (row and column) data but also increasing amounts of “unstructured” data: chaotic high-volume, high-velocity data such as social media streams, emails and webpages.

The explosion of data has been mirrored by a rise in increasingly powerful analytic tools. Among these are IBM SPSS Modeler, SAS Visual Analytics and TIBCO Spotfire. These allow users to make sense of big data by unearthing hidden
patterns and allowing users to explore “what if?” scenarios.

Analytic insights are a potential gold mine for savvy M&A operators. “Using data analytics while planning an acquisition can help stakeholders to visualize the bigger picture, allowing for comparisons, combinations or cutting of duplicate resources to be made to help maximize revenue and minimize costs,” says Brian Gentile, Senior Vice President and General Manager of TIBCO Software’s Analytics products business unit.

Predictive analytics – which combines the use of data, algorithms and machine learning to make predictions about the future – is an increasingly important part of the picture. “While the acquisition is going through the buying process, predictive data analytics techniques can also be used to see how the market will likely respond after a deal is made,” says Gentile. “Ultimately, such specific analysis offers the security required to justify such an important activity.”

Potential data sources for M&A include contract data, intellectual property (IP) portfolios, escrow payments, human resources data, sales figures and customer data and the torrent of data generated by social media. The ability to use that data effectively can make all the difference.

UK-based big data software specialist Syncsort, for example, used its own analytical tool to assess targets before settling on its acquisition of Circle Computer Group. Analytic approaches enabled Syncsort to weigh up likely cost-savings, as well as cross-selling opportunities resulting from the purchase.

Analytic techniques can be used to enhance due diligence on both the buy and sell side.

EY’s Cyber Econ, for example, analyzes the target’s business ecosystem to identify risks embedded in complex subsidiary relationships. “Understanding the wider security environment is becoming almost a diligence prerequisite and it can only be enabled by technology,” says Liu.

Smarter tools are helping to make complex deals easier. Partial divestitures (carve outs) are an example. “We’re using technology to help corporates package-up a range of options to present to a buyer – and to then track how those are being processed during due diligence,” explains Pearson.

“We’re just starting to apply analytics in a more robust way to look at assets and really understand what’s going on with the asset that’s being traded.”

Going further with tech

Many of the technologies underpinning today’s M&A deals are now well established. Innovation lies in how these technologies are put to work. “Getting better results starts with asking better questions,” says Liu.

Dealing with intangibles

Analytics is being used to probe the value of intangibles. IP is a case in point: when a target’s value hinges on the ownership of rights, such as patents, it’s vital to know how often the target is filing, how much overlap the firm’s portfolio has with competitors and whether the company is retaining talent.

“This is particularly helpful on the buy side when you’re weighing up two apparently similar companies,” says Pearson.

Deal terms

Number crunching techniques help participants to settle on deal terms. Analysis of historic transactions makes it possible to determine escrow amounts and draft deal provisions.

“There are products that will let you plug in the deal provisions and compare them with the most recent 100 transactions, giving you a percentage of them that have a particular provision,” explains Roger Griesmeyer, Partner at Andrews Kurth LLP.

Doing more with data

According to market research firm International Data Corporation (IDC), unstructured content accounts for 90% of all digital information. Social media analysis, for example, can assist when valuing young, fast-growing companies where historical data is scarce. “New technologies give you different lenses with which to characterize value,” says EY’s Liu.

Easy-to-use data builds buyer confidence, says Pearson: “The more clarity you can give as a seller, the higher the price you’re likely to get.”

Analytic tools used for due diligence can also transform business performance post-deal. “Smarter corporates are looking for a return on due diligence and are looking for flow-through into business planning post-deal.”

Looking forward

The pace of technological change in M&A shows no sign of slowing. Big data techniques – such as predictive analytics – are likely to grow in prominence, boosting transparency and raising the bar for all participants.

However, the importance of the human touch should not be underestimated: “Doing things remotely means you miss out on a certain amount of touch and feel,” says Pearson.

The secret is to strike the right balance: “If you can ally commercial judgment with a structured process and some good analytics, you will end up with a stronger, more reliable and more robust process at the end of it.”

For further insight, please email editor@capitalinsights.info
The UK has regained its mantle as Europe’s thriving hub of deal activity. But what is attracting investors to British shores and how can they navigate the business climate?

According to Mergermarket data, UK deal values for the first three quarters of the year (US$263b) outstripped the whole of 2014 (US$157b). And the UK accounted for 39% of overall M&A activity in Europe, up from 15% during the same period in 2014. While politicians and the media are increasingly absorbed by the “Brexit” debate, the possibility of a British exit from the European Union (EU) is not yet crimping deal appetites. In 2015, deals worth US$254.1b targeting the UK, increased by 63.4% on 2014 figures.

In line with global M&A market trends, megadeals are driving an increase in UK M&A values. Standout deals included the US$81.2b oil and gas sector acquisition by Royal Dutch Shell of the UK natural gas giant BG Group in April, and BT’s takeover of mobile telecom group EE for £12.5b (US$18.3b).

It is the UK economy’s traditional strengths that are driving this M&A revival, says Steve Varley, Chairman and UK&I Managing Partner at EY. “There are a number of factors [contributing to the upsurge of M&A] – from the stable government, good legal and financial system, [to the] protection of intellectual property,” Varley says. “The UK continues to be a good place to do business, at a time when all jurisdictions have got harder to do business in.”

Transatlantic traders
A key trend contributing to the revival of the UK market is US-buyer interest. The US$26.9b-worth of deals targeting the UK jumped 58.1% from the first half of 2014, driven by deals targeting business services (US$9.5b) and industrial and chemicals (US$8.8b) sectors, and with business services reaching its highest first half deal value on Mergermarket record. Domestic activity has also increased: in the year to September 2015, deals between UK companies were up almost 20% year-on-year in value, EY data shows.
“Transactions across the spectrum appear to be pretty strong,” says Andrew Hornigold, a Partner at law firm Pinsent Masons, who points to the bevy of deals in telecoms, media and technology (TMT). “We’ve obviously got a really broad spread of deals [from megadeals, such as] BT and EE right through to the start-up tech businesses that continue to attract interest especially in and around London, as well as subsectors like fintech and cybersecurity.”

**Number one for M&A and FDI**
The UK reinforced its appeal to foreign strategic investors in 2015, named the most attractive country with a substantial 43.3% share of Europe’s inbound investment in the first three quarters of 2015, according to Mergermarket figures. UK assets have sparked interest from Asian firms spending on big-ticket deals in 2015, leading to 69 deals valued at US$40.9b. The UK was the leading foreign direct investment (FDI) destination for US investors in Europe in 2014, with 36% of all investment projects located in the UK last year being from the US. The next nine most-important origins of UK investment – including France, Germany, Japan and China – collectively accounted for 42%, demonstrating the UK’s heavy reliance on US FDI.

In fact, in EY’s *Attractiveness Survey: UK 2015*, 52% of global investors listed London as the more attractive European city for FDI, ahead of Paris and Berlin. In the World Bank’s *Ease of Doing Business 2016* rankings, the UK is in sixth place globally. The reason the UK is attracting such high FDI, says Jon Hughes, UK&I Transaction Advisory Services leader at EY, is partly down to the country’s good governance. For example, the UK is ranked as the fourth-best globally in terms of protecting minority investors, according to the *Ease of Doing Business* survey. “There is very little inappropriate intervention from the Government with regard to blocking inbound or outbound activity,” Hughes explains. “It’s a very well regulated, very well understood, very well understood, tried and tested market to transact in with minimal government interference.”

**EMU rules but TMT hot**
Energy, mining and utilities (EMU) dominate the top five M&A sectors by value, at US$90b, influenced by the Shell and BG transaction. TMT remains hot, coming second in deal values at US$53.2b, followed by financial services on US$28.7b, business services on US$20.2b and leisure at US$18.1b. London has cemented its position as the most important tech hub in Europe. UK tech start-ups secured a record £437m (US$655m) in funding in the first quarter of 2015, according to analysis by London & Partners.

Convergence, the desire for innovative intellectual property (IP) and big data are key drivers as other industries move into the tech sector. Law firm Reed Smith’s 2015 report, *Wired Up*, says new devices, methods of delivery and types of content will spur M&A activity, as businesses scramble to grab an audience and consolidate competitive advantages.

In addition, there are two other factors driving growth – large corporates cash piles chasing rare and expensive assets and private equity houses still sitting on funds that they need to deploy.

“From the megadeals right through to consolidation around cloud delivery, it’s a long-term trend,” says Hornigold. “The sheer volume of data out there is increasing demand for data-centric capacity.”

While cutting-edge technology such as wearable technology isn’t necessarily an established market yet, sectors such as cloud...
and mobile have established customers and recurring revenues.”

Some foreign businesses are moving rapidly up the food chain, taking ownership of defensible IP. In 2014, China’s Huawei bought Cambridge-based Internet of Things pioneer Neul for US$25m. “This firm was more or less a suite of patents around the spectrum that was vacated when there was the digital switchover of signals. It was quite a smart buy by Huawei as they are aiming at a center where lots of market watchers are predicting big growth in terms of interconnectivity,” says Hornigold.

Tech firms are showing more interest in data-driven connectivity and device-embedded services. Pinsent Masons advised on the 2015 sale of UK-based smart ticketing provider Applied Card Technologies (ACT) to Japan’s Fujitsu. ACT’s technology enables Fujitsu to provide cloud-based tickets to transport operators, offering a service that could replace paper tickets. Management consultancies are rapidly buying digital businesses, incentivized by the fusion of technology and marketing, says Mandy Merron, a Partner at UK-based advisory firm Kingston Smith LLP. “The main driver is the very basic systemization of human processes and the movement of marketing along the consumer journey right up until point of sale and all points in between.”

The outlook for M&A in 2016 will be solid, says Varley. “But the way we get there is not going to be in a straight line. This is not going to be an easy journey. And there will be fits and starts.”

UK deal drivers
Like many nations, UK M&A has been driven by megadeals, corporate confidence, robust corporate balance sheets, uncertain emerging markets and cheap debt. But Britain has specific attractions. Overseas investors point to a reduction in operating costs in the UK — 50% of respondents to EY’s April Capital Confidence Barometer (CCB) quoted measures such as a decrease in corporation tax, improving real estate availability and cost, and lower labor costs as a route to higher future competitiveness.

In April, EY’s CCB predicted a new wave of M&A activity, as 58% of UK respondents expressed an intention to buy assets over the next 12 months — the most EY has recorded in six years of gauging

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36% The UK was the leading FDI destination for US investors in Europe in 2014, with 36% of all investment projects locating in the UK last year being from the US.

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How to get the best deal in the UK
Capital Insights reveals the five key factors to doing business in the UK.

Keep your eyes open for newcomers. The UK tech sector is hot at the moment and corporates need to get onboard now. “It is a good time to go and do deals as there are plenty of people who want to sell, so buyers aren’t having to winkle out difficult-to-find targets,” says Mandy Merron, Partner at Kingston Smith.

Beware the rise in shareholder activism. UK companies have seen an increase in shareholders engaging more closely with the companies in which they invest. “When dealing with a listed company as a party on M&A deals, consider what formal shareholder approvals are needed, and what investors’ informal reactions are likely to be. It is vital both to understand what execution risks these may present to the deal, and to plan the board’s engagement strategies to minimize these risks,” says Gavin Davies, Partner at Herbert Smith Freehills LLP.

Think outside your own sector. Convergence is a growing theme in the UK. As the BT and EE merger shows, a multiplatform access offering can prove a compelling proposition for dealmakers.

Beware of Brexit, but don’t let it break a deal. Brexit is going to cause issues if it happens but it’s still a way off. “While companies definitely need to fully assess the risks and consequences of the European debate, they also need to take a broad-based view of the UK’s overall position in the global trading network,” says EY’s Steve Varley.

Take precautions. Despite the UK’s burgeoning M&A market, dealmakers need to pay heed to due diligence. “Go through a full review of documentation and ensure that you identify areas where a buyer might have any queries; anything to reduce the risk of the buyer finding a reason to change the deal,” says Andrew Hornigold, Partner at Pinsent Masons.
global corporate confidence. Three-quarters of UK companies are planning innovative investments as they respond to disruptive sector drivers and reposition their business.

EY’s October CCB brought even better news for UK M&A, bumping record-setting April predictions, with 59% of UK respondents expressing an intention to buy assets over the next year. The report suggests strong domestic growth will continue through 2016.

“We think the mid-market’s going to remain very active as businesses grow, especially as they look to technology to take their businesses forward,” Hughes explains. “We think pharma, life sciences and health are going to remain strong.”

**Dealing with challenges**

Despite its burgeoning M&A market, assets and its strong position businesswise in the global race to attract business, the UK still has challenges to overcome if it is to stay ahead of its competitors.

The threat of a referendum on EU membership or “Brexit” has investors nervous. According to EY’s Attractiveness Survey: UK 2015, investors plan to freeze investment in the UK in the run up to an EU referendum. The uncertainty caused by a UK EU referendum will be disruptive and is a risk to the UK investment. Some 31% of investors stated they would either reduce or freeze their planned investments up to 2017.

“The concern about Brexit is absolutely valid,” says Hornigold. “To draw a comparison, when we were looking at transactions in the run up to the Scottish referendum in September 2014, clients were definitely putting things on hold to await that impact. If we are looking at either a UK referendum or other members of the union exiting, that does have an impact on non-European countries’ views of the market as a whole.”

According to Varley, there is a particular concern about the Brexit domino effect. “For the UK, Brexit puts Scotland and the union at risk,” he says. “Brexit could be just the first domino to go.”

In a recent statement, law firm Hogan Lovells wrote that unless replacement arrangements equivalent to the current cross-border passport regimes can be secured, financial institutions...
The UK is currently way ahead in the M&A stakes. Indeed, the country accounted for 39% of overall M&A in Europe this year. However, if this trend is to continue, there are four key challenges that need to be addressed.

**Low productivity**

Britain’s low productivity growth since the 2008 recession has been described as “historic” by the Office for National Statistics. The gap between productivity in the UK and other members of the G7 is now wider than at any other time since it was first recorded in 1991. While output per hour in the rest of the G7 has recovered and now exceeds pre-crisis levels, Britain’s productivity remains well below. Looking across the G7, Britain is around 17% less productive than the US, Germany and France, and only exceeds Japan.

**Skills shortage**

Part of the reason for the stunted productivity is a shortage of engineering and technology talent. According to the Global Skills Index compiled by recruitment group Hays and consultancy Oxford Economics, employers have virtually been forced into a battle for talent. Alistair Cox, Hays’ Chief Executive was quoted as saying: “UK growth prospects are better than they have been in a long time, but employers are facing ever-greater challenges around finding the talent they need.” In a knowledge-based economy, where ‘acqui-hires’ are becoming increasingly commonplace, this skills shortage needs to be addressed urgently.

**Mid-market malaise**

Small to medium-sized enterprises (SMEs) and mid-market firms are seen by many as the lifeblood of UK business. They are also vital to continued M&A growth. However, these firms are facing a funding crisis. According to the Confederation of British Industry (CBI), the total stock of medium- to long-term (non-overdraft) bank lending to SMEs has fallen by £23b, down 22% since the start of the financial crisis. With banks, the traditional source of funding to this sector, seeking to de-risk their balance sheets, SMEs have turned to alternative lenders such as peer-to-peer funding - but whether this can act as a long-term solution is debatable.

**Breaking away**

The in/out decision in the EU referendum (or “Brexit”) may take place earlier but it is likely to be in 2017. Most experts believe that this uncertainty ranks higher in the investment and strategic decisions of companies than “Grexit” or the prospect of Greece leaving the Eurozone. Markets dislike uncertainty and some firms may put off investment and headquarter location decisions until Brexit is resolved. As the Eurozone builds institutions to support the single currency, which could take decades, there will be implications for the non-euro EU countries such as the UK. And this could be exacerbated by the UK breaking away from the EU. Policymakers will need to fashion a concrete plan to reduce that uncertainty as much as possible.

For Britain, setting out a plan to address these challenges will be key to raising economic growth and keeping the M&A juggernaut on the road. Operating in both the UK and EU may need to establish new entities on each side of the EU border. For example, in life sciences, subject to the transitional arrangements introduced, a Brexit could disrupt supply chains, cause additional quality control testing, new export charges, and uncertainty regarding elements of the regulatory regime, such as the validity of crucial EU regulatory authorizations.

According to Colin Welsh, CEO of Simmons International, an Aberdeen-based corporate finance advisory in the energy sector, uncertainty around business profitability over the next 12 to 18 months will cause a big drag in M&A activity, making it difficult to accurately price deals. “We’re seeing public companies cleaning out their backyards and divesting of some things that aren’t core to them, notwithstanding the fact that the prices they’ll receive won’t be that great. There are a lot of companies where private equity [firms] bought these businesses at 10 times EBITDA, with five times EBITDA of leverage. So, I think that those are the companies that you’ll see in some difficulty.”

For further insight, please email editor@capitalinsights.info
Despite overall signs of positivity, the Asia-Pacific region is exercising cautious optimism when it comes to deal activity over the coming 12 months.

Despite the economic headwinds that the Asia-Pacific region has experienced over 2015, respondents to the latest Asia-Pacific Capital Confidence Barometer (CCB) indicate a cautious optimism about the region’s prospects. Companies are preparing their response to these challenges using a variety of organic and inorganic strategies while remaining diligent about costs and efficiencies.

Lower levels of economic growth in China, as the economy rebalances, volatile currency movements and downward pressure on commodities have all played a major role in the region’s economic performance in 2015. Yet the outlook expressed by Asia-Pacific respondents to the CCB shows a more positive outlook for both the local and global economic conditions in 2016.

The survey results show a balanced and disciplined response from Asia-Pacific companies in how they plan to achieve their growth targets.

Having acclimatized to lower growth in the region and globally, executives remain resilient about the big picture. CCB results tell us that 53% (up from 44%) of Australian and 48% of respondents from Thailand expect to do a deal.

Momentum in China continues apace, with 2015 seeing record-breaking deal value of US$601b, the highest in 10 years. Looking forward, deal pipelines are likely to remain robust, with more than 90% of Chinese respondents indicating that they have three or more deals on the go.

The story continues across the Asia-Pacific region, with US$1.4t of deals announced this year. This represents an increase of 58% on 2014 and a new record for the region – a sure sign that companies are using acquisitions to counter low growth. They are looking to gain market share and boost the bottom-line through cost-synergies. However, this upturn in M&A is balanced by the discipline companies are showing when looking at potential targets.

This forward-looking approach to growth, coupled with the resilience about economic conditions and discipline in dealmaking, bodes well for corporate performance in the Asia-Pacific region in 2016 and beyond.

The headwinds will likely persist but companies are looking for positive ways to respond and overcome these challenges.
We're in the midst of long-term economic warfare, played out in cyberspace: the most devastating hacks are the ones you don't know about, aimed at your strategic, financial and deal data.

Hacking has been part of popular culture for as long as there have been computers. From 1960s *The Italian Job* to *The Matrix*, the hacker has a well-developed public image: smart, geeky, introverted, socially aware, perhaps motivated by the thrill of the breach as much as by the money. This image is mostly wrong. According to EY Partner with Ernst & Young LLP Doree Keating, the reality is far more prosaic. “This is really about economic impact,” she says. “The digital dimension is relatively new, but business leaders are better to think of this in the age-old context of fraud, manipulation and industrial espionage.”

In 2014, the hack of a major US bank, for example, was the foundation of a traditional pump-and-dump share trading scam. The 80 million customer records stolen were effectively used as a mailing list to target fraud. The victims

Of course, the US bank hack is just one case in many thousands. Media attention focuses on these big, embarrassing breaches – the Sony Pictures hack, for example, which involved as much as 100 terabytes of data, or the 25 gigabyte Ashley Madison adultery website hack, which led to a US$567m class-action lawsuit from its members.

State actors, organized crime, hacktivists – the classic roll-call of perpetrators. But the high-profile cases are often those with the sloppiest execution.

The recent hack of British telecoms firm TalkTalk is a prime example. Initially, account details for 4 million customers appeared to have been compromised, and the company's market cap fell more than 25%. But the teenaged hackers were quickly caught, and it transpired that only incomplete financial information on 157,000 accounts was accessed. Nevertheless, TalkTalk has still taken a £30m (US$45.6m) hit to their bottom line as a result of the breach – largely thanks to “the response to the incident, the incremental calls into our call centres.”
Cyber economics has three elements: economic, geopolitical and security.

**Economic:** there's a high chance any company is already under a long-term campaign by a nation-state, organized crime or hacktivist. They are trying to erode the company’s revenue, profit, market share, market value or brand reputation.

**Geopolitical:** knowing the threats and regulations in the nations in which you operate — and want to expand into.

**Security:** where most businesses are spending their money — trying to tighten defenses — although this is still seldom mapped against broader economic impacts.

### How big is the problem?

Putting accurate numbers on cyber economy risks is almost impossible. A report from insurer Allianz Global Corporate and Specialty in 2015 put the cost to organizations globally at US$445b. Hewlett Packard and the Ponemon Institute of Cyber Crime believe attacks cost the average US firm US$15.4m. And a World Economic Forum report said adding the effect of attacks on the pace of technology and business innovation bumped the economic cost to US$3t annually.

These figures make uncomfortable reading for individual companies, but there is a worse statistic still. When, according to the UK’s security service GCHQ, 8 in 10 larger companies have already been compromised, it’s not a matter of whether you face cyber economy risks — it’s simply how bad they’re likely to be when they crystallize or the intruder “coverts” the hack for economic gain.

Keating explains: “An intruder will gain access to a network and simply take a watching brief. They’re not interested in stealing big chunks of data — they’re targeting strategic decision-making, market intelligence and financial data, especially around M&A deals. It’s effectively an insider trading play.”

### On board with cyber economics

And boards need to be doing more. “Every company is at risk — but it’s clear that not every board is on top of the issue,” says David Patt, Senior Analyst in Corporate Governance and Public Policy at Legal & General Investment Management. “To some extent that’s understandable. Cyber economic risks are complex, and it’s tempting for boards to push the issue onto the IT department. But we want to see them take more interest in the detail.”

MacDermott agrees. “It’s not just the threat data,” she points out. “Holistically, across the centers, the additional IT and technology costs,” said the company, plus lost sales.

“That’s why cyber economics means being more proactive,” says Keating. “If you have a clearer picture of your own vulnerabilities and those in the systems of your counterparties, you’re much more likely to find the right hygiene level and can plan more coherently should the worst happen.”
enterprise, they need to look at the potential vulnerabilities. When the foundation isn’t laid properly for the convergence of business risks and cyber attacks, nothing else really works well.” Companies should ask themselves how well they are cross-checking anomalies against potential breaches.

More often than not, the problem isn’t software – it’s people. “The insider threat is increasingly rearing its head,” explains David Gibson, Vice President of strategy at data analytics firm Varonis. “There is corporate espionage – competitors going incognito or rogue employees stealing information. But the majority of insider threats are not malicious, but due to employee mistakes. You can teach them how to spot a phishing email, but we’re all human.” The 2015 edition of the Verizon Data Breach Investigations Report revealed that 23% of recipients open phishing emails and 11% click on attachments.

**Deal with IT**

One example of MacDermott’s convergence of cyber and economic risk is in M&A deals. Company value is now rooted in data. Whether it’s IP, market intelligence or corporate strategy, acquirers are often buying little more than the contents of a data center. Second, M&A deals require data to be shared – so it’s hard to keep track of who has access and when. And third: post-merger integration risks bringing new vulnerabilities to a business. “When the board is looking at the strategic rationale for an acquisition, it has to ask: has anyone looked into both the cyber and human security of the target, or the target’s suppliers, or the target’s key markets,” says Keating. “Sysops and systems must be evaluated in the same way key personnel or the financials are. Cybersecurity teams have to be embedded within the broader due diligence effort.”

That’s not commonplace. In a 2014 survey by MWR Infosecurity and Control Risks, 78% of dealmakers said that thorough examination of cybersecurity was not being conducted as part of due diligence. That’s incredible when you consider that a recent survey of 214 dealmakers in international M&A by Freshfields Bruckhaus Deringer found that 90% of respondents believe cyber breaches would result in a reduction in deal value and 83% believe a deal could be abandoned if breaches are identified.

The consequences can be severe. “One company we worked with bought a pharma business, primarily for its intellectual property,” says Keating. “Post-deal, they discovered the target firm’s systems had been breached, intellectual property stolen and the patent to a critical drug registered by a third party in first-to-file domains, freezing the legitimate acquirer out of those markets.”

**Cyber M&A mitigation**

So, how should acquirers protect themselves? “We start with the company itself – doing sophisticated searches to build up a profile of their cybersecurity and identify possible gaps in their approach,” says Keating. “We then follow up with the economic angles: a sensitivity analysis around growth strategies, for example, to illustrate how rivals might target them in a deal. That enables us to show what we can learn before we even touch their network. It’s a real eye-opener for the executive team.”

A deeper probe into past breaches, system robustness and high-value data targets sets out a base-line for the acquirer. Once a target had been identified, a similar process – testing from the outside, a detailed security and economic audit, analysis of past breaches – builds up a picture of their potential vulnerabilities.

“There should also be more focus on the supply chain of the target company,” says
MacDermott. “Do they allow for any type of cyber audit into their systems? More questions should be asked about the root cause of certain deviations from suppliers’ order quantities, pricing and quality. And that’s just a snapshot of what due diligence means as it relates to cyber economics in the transaction space.”

Third-party data centers, or how cloud services are configured are other considerations of a cyber economic approach.

“A detailed entity analysis should include potential links to nation states and organized crime,” says Keating. And this should apply to a target’s suppliers or even shareholders.

Security around the deal itself needs to be stepped up. “We’ve certainly seen cases where there are higher numbers and severity of intrusion attempts during deals,” warns Keating.

According to cybersecurity firm FireEye, a group known as FIN4 targeted more than 100 M&A deals by the end of 2014, probing into the emails and databases of executives and advisors for market-sensitive information.

This highlights how important it is that before a deal is done — especially for a public company, where the acquirer takes on systems “as seen” once they’ve completed the deal — integration must be clear. Acquirers need to have a plan to raise the cyber economic risk management to the highest level of the two parties at any given point of vulnerability.

**Think proactively**

Weaving this kind of detailed cyber economic risk analysis into a M&A transaction can be costly and time-consuming. “It can be frustrating to run this kind of detailed due diligence,” says Keating. “But managing the economic risks more than justifies the effort. People said the same about regulations, like the FCPA, but we have adapted.”

Companies can take steps to document and evaluate their own risk management around cyber economics — which should give acquirers, for example, a clearer picture of where to focus their own investigations.

“Every business ought to be busy identifying any potential issues and being honest about their vulnerabilities,” Keating concludes. “It’s vital to understand how the cyber economic threat is evolving, monitor your own systems, analyze suspicious activity and adapt your tactics accordingly. Having remediation plans is a must — but mitigation of the risk ahead of time is the real objective.”

For further insight, please email editor@capitalinsights.info

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**Viewpoint**

**Brendan Rizzo**

technical director

EMEA for HP Enterprise Security

**Traditional security technologies, including access and authorization, anti-virus and endpoint protection, are inadequate. Businesses do not have the necessary means to protect data as it moves across their organization. Use of cloud-based services and mobile tech increases the risk. Companies need a program that protects at the data level rather than focusing on protecting the “container” in which the data sits (like a network or hard drive).**

Spurred on by unprecedented threats and new regulations, there has been a trend for businesses to allocate a portion of their security spend to address the threat at a more holistic level, by encrypting the data itself. In this way, it can remain protected as it flows through the company.

Many companies offer products to secure evolving platforms like cloud and mobile, and clear leaders should emerge in the next 18 months. So look out for those applying industry standards — like the new mode of AES (AES-FFX) that allows encrypted text to retain its original format. If preventative measures aren’t enough, it becomes a matter of damage mitigation and there are several steps organizations should take:

- **First aid:** stop leaking sensitive data — this is more important than any other company activity.
- **Triage:** understand the breadth and depth of the problem and likely fixes.
- **Lawyer up:** assess the level of investigation, reporting and notification required in affected jurisdictions to set a base response level.
- **Involve the business:** a data breach is not solely a tech issue. An established technical incident response plan involving all teams can save vital hours.
- **Protect your brand:** communication is vital, it should take place early and often. Tell customers what happened, why, what is being done, and assure them it will not happen again.

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Definition: Diversified industrial businesses are involved in at least three significantly different industrial sectors, which could include building products; heavy materials; chemicals and associated manufacturing; packaging; auto, defense, aerospace or rail manufacturers, and their supply chain; manufacturers of capital equipment for the oil and gas, or mining industries. Source: Dow Jones

We examine how diversified industrials are looking to optimize their portfolio with effective acquisitions and divestments.

The world of diversified industrial businesses is, by its very nature, diverse. Including everything from chemicals to defense and beyond, this is an area that comprises some of the biggest companies in the world – household names such as GE and Dow.

In EY’s latest Capital Confidence Barometer, published in October, diversified industrials was identified as one of the top five sectors in terms of appetite for M&A – two thirds expect to actively pursue acquisitions in the next year.

The search for growth
The organic growth of industrials is typically tied to GDP. As a result, organic growth in a low GDP environment can be a challenge. In the US, GDP has been mired in low growth of about 2%, Europe, basically zero, and China which has seen double-digit GDP growth in recent years, has revised its GDP forecasts down into single digits.

“The lack of GDP-driven organic growth around the world has meant diversified industrials companies have been focusing on non-organic ways to accelerate growth,” says John Woodby, Senior Managing Director, specializing in industrial products at EY. “Many businesses are generating a lot of cash due to expanded margins and cautious capital spending programs. So the question is: ‘Should that cash be used for buybacks, dividend increases or M&A, to accelerate earnings per share?’ And the answer is that all of the above strategies are being pursued.”

However, as with almost all other sectors, diversified industrials have seen an upswing in both acquisitions and divestments this year as numerous companies either return to their industrial core or look to take advantage of new areas for growth, particularly in disruptive technologies. One example of the former is GE. The conglomerate is on
course for divesting itself of the vast majority of its financial services business, GE Capital.

**Optimizing the portfolio**
When it comes to portfolio optimization – be that acquisitions or divestments – there are a number of key factors driving the market.

- **Broadening and narrowing the business:** The opportunity to broaden the portfolio while also specializing may seem like a contradiction. However, Woodby points to one particular diversified industrial business that has used M&A to this end over the last two decades – Washington-based Danaher. In the last 20 years, the group has made more than 400 acquisitions, and has transformed itself from an 80's-style conglomerate, into a globally focused portfolio of technological and scientific businesses. Such M&A is a major part of its future. In May, Danaher announced that, after the acquisition of air and water filter maker Pall, it would be split into two parts – a science and technology and a diversified industrial business. James A. Lico, CEO of the business, emphasized the importance of acquisitions for both breadth and focus: “As a standalone company, we will have the opportunity to pursue a more focused growth strategy with a renewed emphasis on M&A for many of these businesses.”

- **Working with activists:** In an environment where activist shareholders are ever more prevalent, the need for diversified industrial businesses to review portfolios and strategies, is perhaps more in focus now than ever before. According to a report published in 2015 by JP Morgan, assets under management (AUM) by activist investors was just US$12b in 2003. By the end of 2014 it had grown by almost 10 times to US$112b.

  “Diversified industrials can be a good target for activists, because by their very nature they are portfolios of businesses that over time can develop significantly different end markets, different growth rates, different outlooks, and different prospects,” says Woodby. “If a company gets complacent about portfolio or capital allocation optimization, activists can be quick to get involved.”

  The key defense for diversified industrial businesses is to carry out regular, potentially quarterly, strategy reviews of portfolio companies and to view dividend policy and capital structure through the eyes of would-be activist investors.

- **Optimizing the portfolio:** As more businesses focus on their core, diversified industrials are aiming to shift from lower margin, cyclical, commodity to higher-growth, higher-margin businesses. It is critical they carry out regular portfolio reviews before someone external to the company does management’s job for them. According to EY’s Global Corporate Divestment Study, published earlier this year, 45% of diversified industrials say activist investors influenced their decision to divest. In order to stay ahead of activist investors.

  And 67% of diversified industrial respondents said reviews should be carried out more regularly than they currently were.

  To realize full value from divestments of a diversified industrial, thorough preparation is key. The key considerations should be around managing shared resources, identifying the relevant staff resource and resolving any environmental issues, optimizing costs and preparing for the transition in advance. However, according to the EY divestment study, just 53% of diversified industrials undertook operational improvements to reduce costs and improve margins prior to their latest divestment.

  Portfolio review, and business structure simplification, has been key to the improved performance of Illinois Tool Works (ITW). In February 2013, Scott Santi, who had recently become CEO, announced a major restructuring of the industrial conglomerate. “ITW had about 800 business lines that were compressed into about 100,” says Woodby. “The company focused intensely on the cost side while also selling off slower growing or more commoditized businesses.” Originally earmarked for a spin-off, its industrial packaging business was sold to US financial services firm The Carlyle Group for US$3.2b in May 2014.

- **Tech know-how:** Using acquisitions to bring in new technology which will improve processes, efficiency and the market offering is another big deal driver. One such example is GE, which stated in October this year that it was exploring acquisitions to expand its newly created digital unit. The company announced that it was targeting US$10b in dealmaking over the next two to three years and a portion of this would be allocated to its “Industrial Internet” offerings. This fits in with the convergence theme that has run through
many M&A deals this year as companies from separate sectors buy into others, often technology, to keep up with changing consumer demands and disruptive innovations.

Diversified obstacles
For the diversified industrials in 2016, valuations remain a major challenge. The other key issue is post-merger integration (PMI).

Valuations
It is certainly perceived that there are fewer high-quality assets coming to market. The significant power for acquisitions that is available in the sector, be that corporates with cash, or PE funds, has resulted in M&A market premiums for high-quality assets reaching new highs, and diversified industrials have been no exception. Of course, in a challenged growth market, quality assets will be rarely available, as owners will be loath to part with their best performers.

“The challenge in this market is not necessarily identifying high quality assets to add to a portfolio, but in finding a willing seller or winning what is likely to be a very competitive auction process,” says Woodby. “We are currently in a seller’s market where there is a significant premium for high quality assets compared to historical averages. And companies are willing to pay that premium for visible growth and strong margins.”

Post-merger integration
The big question for the diversified industrial when making an acquisition is: how will the culture and management of the target work under our ownership? The degree of integration can vary significantly. The most common approach is limited integration. It means the acquisition process is far more nimble; the acquirer will take the benefits of shared service synergies, and then incentivize and trust management of the acquired business to deliver the results. When it comes to portfolio reviews and any subsequent divestments, a lack of integration makes that process far swifter.

However, according to Heinz Meierkord, CEO of Germany-based fiber technology business Advansa, the human factor can be a key hurdle for PMI in the sector.

“In these specialist businesses, the people you have, the team spirit, whether processes are flowing by mutual co-operation, or by enforced procedure, are the big questions,” he says. “In acquisitions, you have to not only look at the technical fit of the product, and the businesses, but also the people, because that is who you will be relying on.”

As for the future, Woodby feels that economic uncertainty may hold back further capital investment and confidence.

“If the global economy continues to be sluggish and uncertainty persists, we could see a continuation of rationalized capital expenditure budgets and focus on inorganic alternatives for growth.”

However, he adds, that while companies are being prudent, they must also be vigilant about value creation.

Among the top tier industrial conglomerates, there is a relentless and systematic pursuit of portfolio and strategy optimization,” he says. “And, in the current environment, complacency could be met with an activist’s phone call.”

For further insight, please email editor@capitalinsights.info
Private equity is undergoing an evolution. As we step into a new year, Jeff Bunder explains one of the emerging megatrends in PE is the opening of this investment vehicle to the everyday investor.

When we look back at the way private equity (PE) has historically been structured, it’s been a small and insular asset class, involving few investors. And because it primarily involves dealings between institutions, it has been viewed as an investment vehicle for the elite.

But when you look at who’s invested in PE today, it’s policemen, firefighters, and teachers – all these people are invested in PE via pension funding and they’re not necessarily aware. When we talk about the democratization of PE, we’re talking about some of the new types of capital that PE firms are trying to tap into. Today, global PE firms manage US$3.5t in assets, but for growth to continue, new capital sources must be found.

Potential new sources include emerging markets, not just as a place to invest, but also as a source for new lending partners. A lot of PE money has gone to work in emerging markets, and firms have also grown their business in terms of developing relationships with pension funds and insurance companies in South America, Africa and emerging Asia. In fact, a lot of the countries in those regions are changing their regulations around PE to allow more involvement to local institutions. That frees up more assets for PE and provides new exposure.

The other trend is in developed markets. And the US in particular is looking at two groups. The first is high net worth investors. We see firms like Blackstone and Carlyle rolling out vehicles to address the high net worth market. This trend has been going on for a while and we certainly expect that to continue.

The other trend – the Holy Grail for PE firms at the moment – is developing access to defined contribution plans. Historically, a lot of PE money has come from pension plans, but pension firms are giving way to 401K funds. A 401K is a workplace savings plan allowing employees to invest a portion of their pay pre-taxes. There are no PE firms with 401K offerings yet, but firms are experimenting with structures to see how that might look. The issue is liquidity. With a typical 401K investment, you’ve got daily liquidity and daily pricing and PE firms are much longer-term vehicles that don’t have that. PE firms need to reconcile that to work within a 401K time structure.

As we dive into 2016, the investor base will, bringing in more retail-type investors. And in 10 or 20 years from now we’ll see a market where alternative assets in PE are a lot more common in the average investor’s portfolio. It’s the natural evolution of the industry. From an investor’s perspective, it makes sense.
M&A maintains momentum

EY’s latest Capital Confidence Barometer reveals a record appetite for M&A.

M&A activity is set to accelerate over the next year with an increasing emphasis on cross-border and cross-sector deals, according to EY’s latest Global Capital Confidence Barometer (CCB).

Based on a survey of 1,600 executives in 53 countries, the report finds that 59% of global companies intend to make acquisitions in the coming year, marking the highest appetite for dealmaking in the six-year history of the CCB.

The quickening pace of acquisitions is, in part, attributable to relatively modest increases in global GDP. Faced with patchy economic performance in key markets, global companies see that organic growth alone is unlikely to deliver the growth they require, driving interest in strategic acquisitions.

Buoyant sentiment in the M&A market is reflected in the fact that more than half of the survey respondents have at least three deals in the pipeline. However, there is also a high degree of caution. Boards are focused on making sound strategic acquisitions. Some 73% say that over the past six months they have walked away from deals that did not tick the necessary strategic boxes.

Despite the positive outlook for the market, challenges remain. Poor operating cost assumptions and poor execution of integration are seen as major post-acquisition obstacles.

Cross-pollination

Disruption is the key word for many businesses. Increased globalization and technology advances see the lines between sectors begin to blur. Organizations cannot afford to sit still.

The CCB found that 16% of businesses see sector convergence and increased cross-sector competition as the most disruptive factor facing their business in the next year. A further 16% believe that changing customer behavior will be the most disruptive factor. While 14% and 12%, respectively, cite product innovation and digital technology.

In response to changing customer dynamics and the moves made by competitors, 48% of global businesses are planning acquisitions in sectors other than their own. This trend is greatest in the manufacturing industry, but there are also significant cross-sector intentions in retail, government, IT and logistics.

Globalization continues to play a major role in shaping acquisition strategies: 70% of respondents are pursuing deals outside of their domestic market.

Despite the publicity afforded to opportunities in emerging regions in recent years, the CCB found that developed markets remain the focus for most businesses’ capital allocation. The majority of companies (53%) are allocating 10% or less of their acquisition capital to emerging markets.

The US remains the top investment destination, followed by the UK, with China and India in third and fourth positions. China continues to attract high levels of investment, while sentiment is positive toward India, not least due to the Government’s pro-business policies. Interest in the Eurozone is strengthening, with 26% of companies reporting increased intention to make acquisitions in the region.

Top five investment destinations

1. USA
2. UK
3. China
4. India
5. Germany

Top five most acquisitive sectors

1. Oil and gas
2. Retail and consumer
3. Mining and metals
4. Diversified industrials
5. Power and utilities
Cross-sector
Are you planning an acquisition in a sector other than your own?
- 48% planning an acquisition outside own sector
- 52% not planning an acquisition outside own sector

Cross-border
Where is the main focus of your M&A strategy next year?
- 41% Outside of domestic market and immediate region
- 30% Domestic market (home country)
- 29% Immediate region (countries close to home)

Preferred destinations

Strategic considerations drive dealmaking
Pip McCrostie is Global Vice Chair, Transaction Advisory Services at EY

Why has M&A continued to rise through 2015?
At the macroeconomic level, global companies are seeing relatively modest growth in key developed markets. Meanwhile, growth is moderating in China. And there is a degree of uncertainty around prospects in other emerging markets. So global businesses are uncertain of achieving growth expectations by organic expansion alone. This is driving a hunger for acquisitions. But there are important strategic factors too: in just about every sector, business models are being disrupted by new technologies and innovative ways of doing business.

What are the key trends in the market?
In 2015 we have seen a marked strengthening of acquisition intentions focused on the Eurozone. The economy has stabilized, and investors see a rich source of high-quality assets. Currency fluctuations and the weakening of the euro have made those assets more attractive. However, recent global security concerns may temper M&A intentions in 2016.

Is the M&A market sustainable?
There is continued interest in US$10b-plus megadeals and this could result in overheating. However, boards are showing caution – not just about megadeals, but about acquisitions in general. Some 73% of CGB respondents said they had walked away from deals and are prepared to continue doing that if conditions are not right.

What are the major challenges?
Of the various challenges, three key risks come to the fore. Integration remains a challenge, while cyber and digital are the big emerging challenges. In terms of integration, the ability of an acquirer to successfully integrate another company on strategic, operational and cultural levels requires a lot of focus. We are also increasingly seeing businesses take a holistic view of cyber risk. That means looking beyond the core systems to every aspect of a business that could be affected by IT failure or cyber attack. More broadly on digital, ensuring that two companies can be digitally assimilated can be a challenge. As is ensuring there is a consistent digital proposition for customers and clients across the newly merged entity.
Cutting the clichés

In the last word, we invite experts from the world of business, finance and beyond to discuss issues affecting corporates. This issue: myth-busting M&A integration.

Given a “make or buy” decision, many firms are opting for the quicker and seemingly easier “buying” growth strategy, and are choosing to merge or acquire. According to Mergermarket data, M&A value reached US$2.9t for the first three quarters of 2015, representing a 21% increase on the same period in 2014. Based on activity rate at the time of writing, it is estimated that total deal value will reach around US$3.9t by the end of the year — a 4.5% increase on the previous peak, set in 2007.

Growth through M&A is appealing. But, simply completing a transaction does not move a firm ahead of the competition for very long. Most deals today are strategic, with targets in the same industry having complimentary products and serving similar customers. Therefore, to maximize the long-term value of deals, there must be a successful integration of people, processes, and systems.

A key risk is that, after the deal, the organizations fall apart rather than come together, destroying value. And the market is unforgiving. Analysts and investors alike can see that deals are often harder to make work than they are to do. Senior teams disproportionately focus their attention, time and resources on the activities leading up to a deal and on the deal itself: forming an acquisition strategy, locating target companies that fit that strategy, investigating those companies via due diligence, and negotiating deal terms. The period prior to and during the deal is when value is assessed, planned, forecasted and agreed. But “post-deal” (during integration) is when value is realized. In M&A, the difference between winners and losers is not simply doing deals: it is in making the deals work.

Management must be aware of and avoid the killer phrases frequently used during M&As. These phrases are too often stated by management about the deals they are doing. Here are six of the most common killer phrases, and the reality behind each of them:

“This is a merger of equals.” There is no such thing. No matter how similar two organizations appear on paper, there are always differences in leadership, operations and culture.

“It is too early in the deal to begin planning for integration.” It is never too early. Delaying the start of integration only serves to lengthen the coming together of the combining organizations’ people, processes, and systems.

“We don’t need to tell the employees anything until there is something to tell.” There is always something to communicate and information to share — if not decisions, at least the progress along the way.

“We’ll freeze the organization for at least a year, and once things settle down we’ll start integrating” or “We’ll ease the changes in.” Slow integration only increases the depth and duration of the inevitable productivity drop. Fast integration — at a prudent speed — protects productivity.

“Now that the transaction is complete, the deal is done.” Nothing is further from the truth. In fact, the real deal is just beginning.

“We don’t need any special integration measurement or progress tracking. We are there every day and can see how integration is going.” Management must regularly track and report integration progress against key milestones and synergy targets. If integration isn’t measured, it won’t be managed.

Any of these killer-phrase approaches alone can be a value killer. Two or more of them together can be a quick and powerful route to destroying deal value. As soon as senior leaders hear any of these phrases being uttered, a caution flag should go up. Worse, if senior management themselves are using these phrases, the deal is doomed from the start. Avoiding these killer phrases — and their associated killer actions — can encourage effective integration, and will help maximize the value of any deal.

“The last word

“In M&A, the difference between winners and losers is not simply doing deals: it is in making the deals work.”

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Capital Confidence Barometer
88% of oil and gas execs expect the oil and gas deal market to improve over the next 12 months.

29% of financial services execs believe the valuation gap will widen over the next 12 months.

59% of auto companies expect to pursue acquisitions in the next 12 months.

Capital Confidence Barometer
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