November 2018 | 19th edition | Australasia highlights
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Global Capital Confidence Barometer

In an age of M&A complexity, do you pause or proceed?

Local M&A plans forge ahead while global peers consider their options

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74%
of executives see the local economy improving

Economic optimism remains strong, despite geopolitical instability and local political leadership changes...

71%
of executives believe short-term market stability is improving

...with **high levels of confidence** in every measure of capital market performance.

99%
of executives expect the local M&A market to be stable or improving

Executives continue to see a **robust deal market**...

92%
of executives expect more or the same no. of deal completions in the next 12 months compared to last year

...with **new market entry** as their key M&A driver and local dealmakers more focused on cross-border transactions than their global counterparts.

57%
of companies found an asset to divest as part of their latest portfolio review

This is important as studies show **companies that balance acquisitions and divestitures outperform** those that focus solely on one or the other.

36%
of companies are starting integration earlier to unlock synergies

When it comes to integration, business units need to be brought on early to help **develop synergy assessments during due diligence**.

75%
of companies expect increased competition for assets

Executives expect **competition for assets** from Private Equity and other forms of capital.

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M&A sentiment remains strong in Australia and New Zealand

Our 19th *Global Capital Confidence Barometer* finds Australian and New Zealand executives expecting the M&A cycle to continue at elevated levels. An unprecedented **99% believe the local M&A market will remain stable or improving**, with more than **92%** expecting more or the same number of deal completions in the next 12 months compared to last year.

More than half (53%) plan to actively pursue M&A in the next twelve months – significantly above the long term average of 43%. Nine in ten respondents expect their M&A pipeline to either increase or stay at the same level in the next 12 months.

Yet, their global counterparts have a less rosy market outlook. While respondents expect heightened levels of M&A, there is a decline in the percentage that expect to make acquisitions themselves in the next 12 months, with plans for M&A trending down to 46%. This puts global M&A appetite at the lowest point for four years. Signalling that some global executives are looking to other companies to do the dealing rather than acquire themselves.

We have seen this dichotomy before in our survey. This is an indication that we will likely see a temporary pause in activity outside of our market. And it may be an important signal for the local Australian and New Zealand markets, which tend to lag global sentiment.

Overseas, regulatory and trade policy uncertainty is clearly giving some executives pause for thought, as is the need to fully integrate and properly digest acquisitions made to date.

Locally, a third of executives are now concerned about the implications of geopolitical risk on business growth. A year ago, only 16% said political uncertainty was a prominent feature in boardroom thinking. They also cite regulatory or government intervention as the primary reason for failing to complete or cancelling an acquisition.

Will local resilience in Australia and New Zealand continue? Or are we heading for a pause in M&A appetite for deal making as local executives follow the global trend?

David Larocca
EY Oceania Managing Partner
Transaction Advisory Services

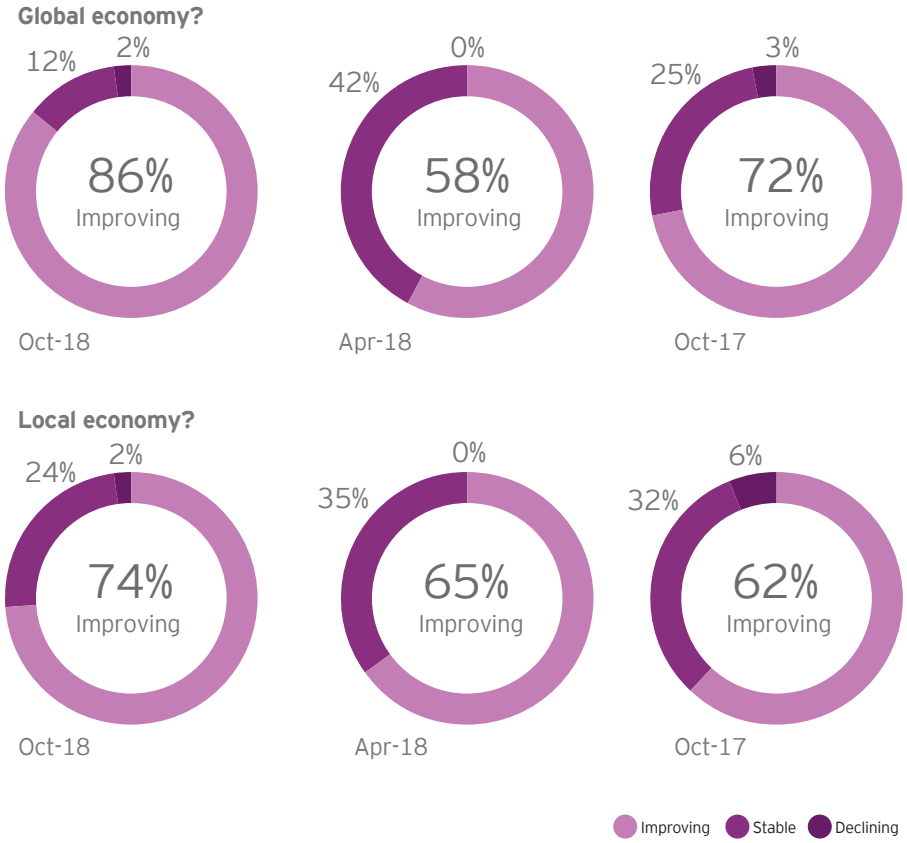
Macroeconomic and external environment

Respondents continue to see upside in the global and local economies. But warning signs may be appearing on the horizon.

Regulatory, geopolitical and policy uncertainty is not denting confidence in the global or local economies. Our respondents remain optimistic about the outlook for the global economy despite a plateau in GDP growth – albeit at healthy levels – and the presence of significant policy uncertainty. Similarly, regardless of growing concerns about the implications of geopolitical risk on business growth, 98% of those same executives think the local economy is stable or improving.

Clearly, the recent leadership changes across New Zealand and Australia have not dampened the local economic mood. The sustained positive outlook may be the result of a number of factors including: increased private consumption; recovering business investment, especially in construction; record levels of government-supported infrastructure investment; and the continuation of bearish interest rate settings, even in the face of increasing US rates.

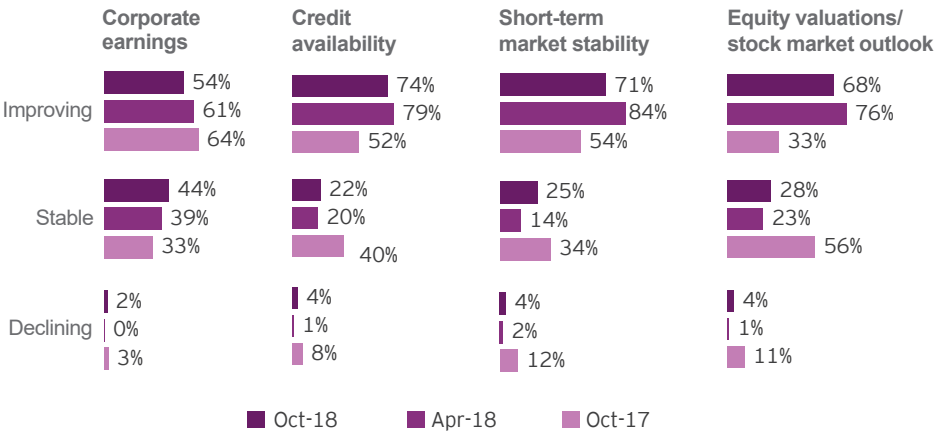
Q What is your perspective on the state of the...



Local capital markets remain upbeat – but consolidation is emerging

After a significant uptick in capital market performance expectations between October 17–April 2018, results begin to point to a more stable outlook. Respondents continue to have high levels of confidence in every measure of capital market performance (corporate earnings, credit availability, short-term market stability and equity valuations). However, the trend is stabilizing. Corporate earnings in particular appear to be entering into a period of steadiness with respondents split between 'improving' (54%) and 'stable' (44%).

Q Level of confidence at a local level



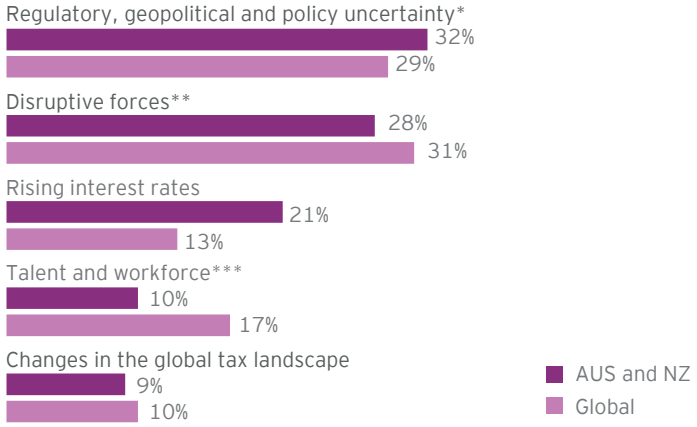
Uncertainty – in all forms – is the new normal

Local executives believe the two biggest near-term threats to business in Australia and New Zealand are: regulatory geopolitical and policy uncertainty (32%); and technological disruption (28%).

Regulatory and political uncertainty, which has been the top concern for three consecutive surveys, continues to trend upwards. Executives are treating 'uncertainty' as business as usual and executing their growth plans despite geopolitical instability. In this environment, new trade and tariff policies will need to be clearly understood amid heightened policy uncertainty.

At the same time, the pace of change wrought by technology, especially technology that enables customers to adapt preferences or buying behaviours, cannot be underestimated. Executives are continuing to focus on these disruptive forces even as they negotiate other risks.

Q What do you believe to be the greatest near-term current risk to the growth of your business?



*Regulatory and governmental intervention in business issues and M&A, and geopolitical and policy uncertainty (includes trade, tariffs, increasing protectionism and barriers to the free movement of labor)

**Includes technology, digital, sector blurring, changing customer behavior and competition from non-traditional players (includes startups and digital/online businesses)

***Problems in identifying and hiring people with the right skills, and reskilling the current workforce

Different global and local perspectives reveal divergent environments

Australia and New Zealand executives generally share a similar outlook to their global peers about the risks facing their businesses. However, for local executives, political uncertainty is seen as an even greater risk than disruptive forces. Respondents also diverge on the comparative influence of rising interest rates (21% local; 13% global), reflecting the relative local exposure to exchange rate dynamics. Finally, more restrictive immigration settings in Australia and New Zealand are yet to flow through into the risk environment, with fewer local businesses reporting high risks in recruiting and hiring people with the right skills locally than globally (10% local; 17% global).

Q What is the biggest potential risk to dealmaking in the next 12 months?

*Regulation and government intervention and political uncertainty and the rise of protectionism

Corporate strategy and portfolio transformation

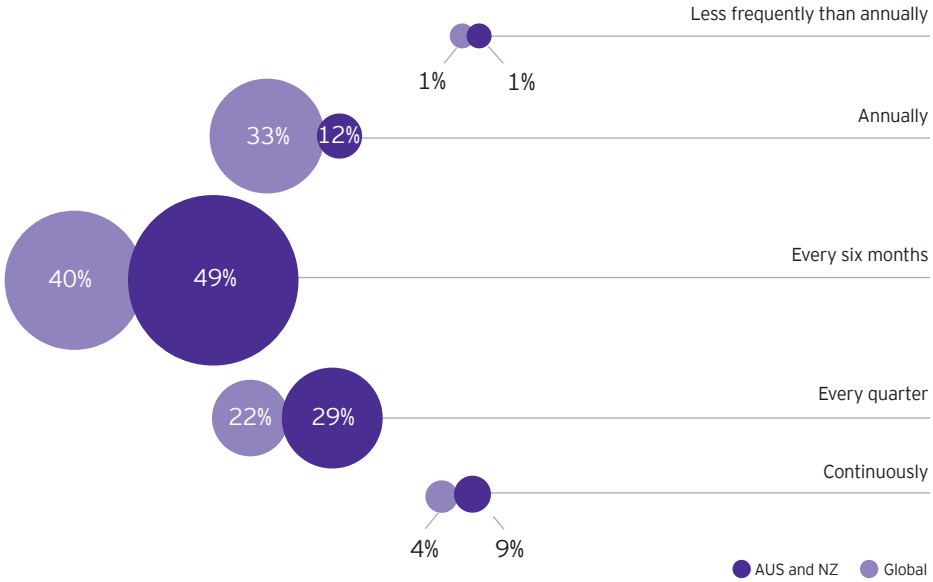
In an uncertain landscape, executives are reviewing portfolios more frequently – to great effect.

Ever present disruption from changing consumer preferences and emerging technologies has local companies reviewing their portfolios more frequently than global peers. Locally, quarterly reviews have jumped from just 1% to 29% in six months while annual reviews fell correspondingly from 44% to 12%. One in ten (9%) local companies are now reviewing their portfolios continuously.

These increasingly frequent reviews are presenting organisations with a more balanced and highly valuable view of acquisitions and divestitures. Nearly a quarter (24%) of companies identified areas where acquisitions are warranted – up from 14% six months ago – much closer to the 35% who identified underperforming assets to divest.

Those increasing the frequency of portfolio reviews are on the right track. Studies show companies that balance acquisitions and divestitures generally outperform those that focus solely on one or the other.

Q How frequently are you reviewing your portfolio?



Q As a result of your most recent portfolio review, what was the main action taken?

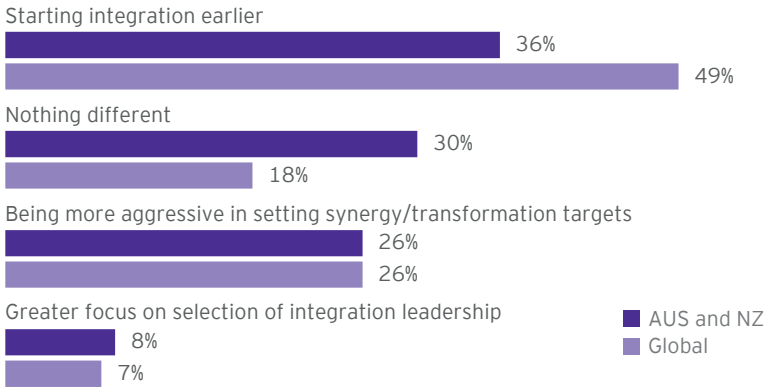
Greater competition for assets puts spotlight on synergy value

As competition from private equity and other players activity increases in the local market, we are seeing a heavier emphasis on unlocking value through achieving synergies. However, this is likely to be a challenge as companies are currently struggling to meet targeted synergies, with 38% achieving lower synergies than anticipated in their most recent deal.

Part of the answer may be to make post-deal integration a pre-deal consideration. Acquiring companies will increase the likelihood of capturing synergies if they map them out upfront and assign accountability for monitoring their progress. Business units need to be brought much sooner to help develop synergy assessments and promote buy-in very early in the process, ideally during due diligence.

Local companies are behind their global peers in this regard, with 36% (versus 49% global) planning to start integration earlier. Tellingly, just under half of local executives (48%) looking to move integration plans forward in the deal process had achieved lower levels of synergies than expected in their most recent deal.

Q In an elevated deal market, what are you doing differently to increase the likelihood of capturing the synergies required to justify the cost of transactions?

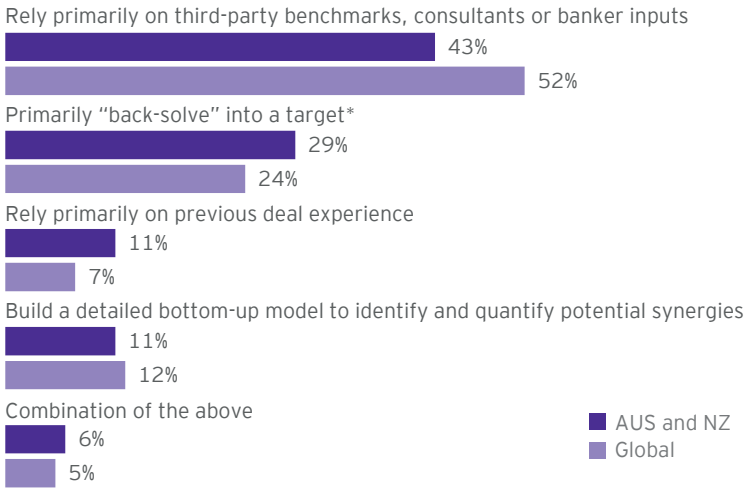


Executives relying on broad benchmarks may underestimate potential synergies

Two in five (41%) local executives say they achieved the synergies identified in their last deal, but are they underestimating the potential of their acquisitions? The *Barometer* finds local companies are not being as aggressive at identifying synergies as their global counterparts. Given 43% of local companies are relying primarily on generic benchmarks, they may be missing the real synergy opportunities in their deals.

Executives should be using a detailed bottom-up model that requires deal teams to look at the full range of positive synergies related to cost, revenue, taxation, balance sheet and capabilities such as technology that brings together the strengths of newly combined assets to deliver higher sales and margins. This is a more reliable and robust approach to calculate potential synergies, which also has the advantage of holding management accountable to targets set with reasonable assumptions.

Q How do you calculate the synergies you hope to achieve from a transaction?



*Required synergies to make the transaction viable given the premium paid

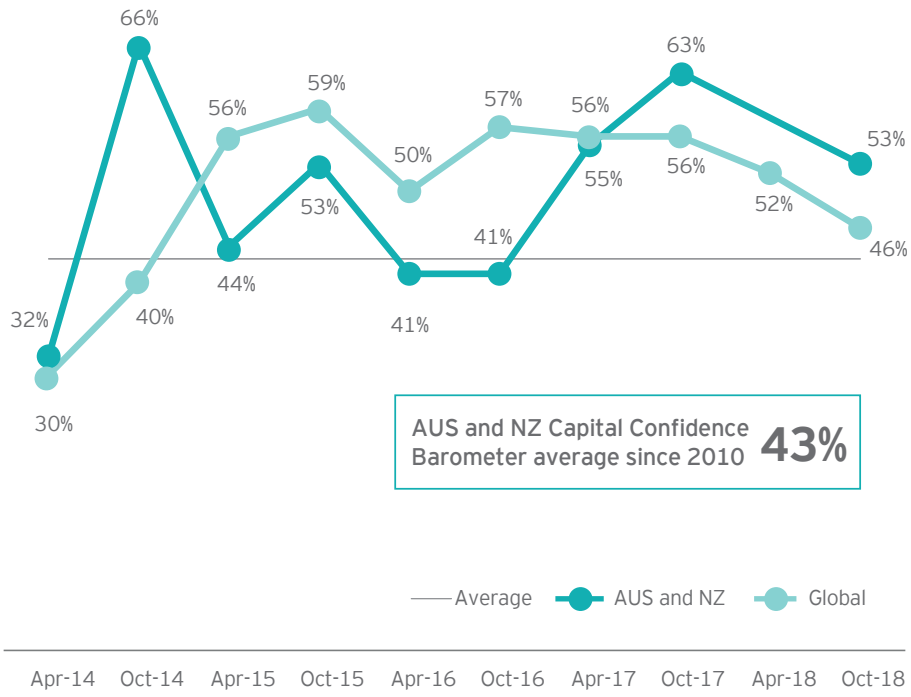
M&A outlook

The strong M&A market is expected to continue as executives predict improving deal environments globally and locally. But are they underestimating the competition?

With the first half of 2018 global M&A at near record levels, executives continue to see an elevated deal market. However, the significant number of megadeals seen during the first half of 2018 (33 deals over US$10b) may not be replicated in the near term. We expect a downturn in megadeals as executives look at evolving regulatory and anti-trust environments, but deal flow in the US$1b-US$10b level should remain robust.

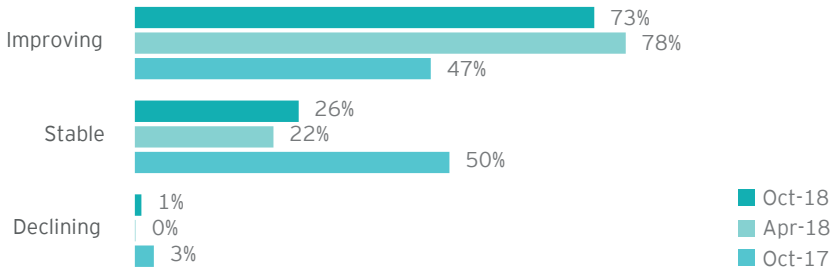
Locally, 7 out of 10 executives anticipate improvement on an already buoyant M&A market. A solid 92% say their pipelines will increase or remain the same in the next 12 months, with 3 in 5 expecting to complete a greater number of deals in the coming year compared with the previous one. This reflects the sustained positive outlook for the local economy and high confidence levels in continued buoyancy in capital markets.

Q Do you expect your company to actively pursue M&A in the next 12 months?

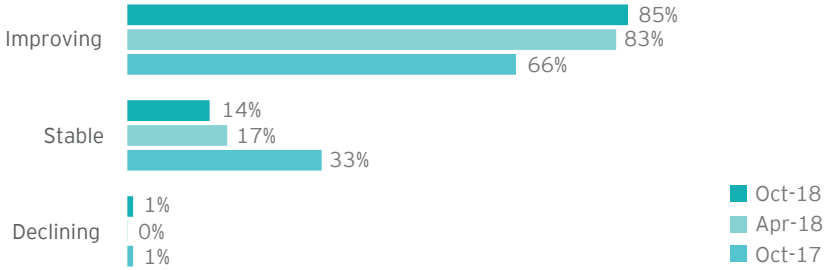


Q In the next 12 months, what is your expectation for the...

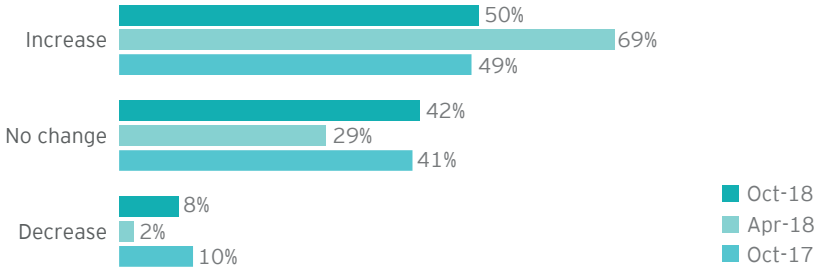
Local M&A market?



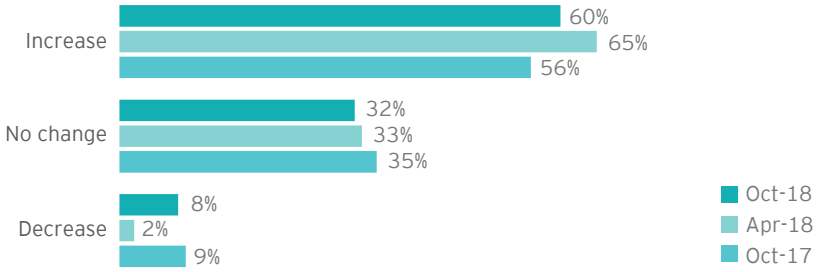
Global M&A market?



Q How do you expect your M&A pipeline to change?



Q Considering the next 12 months, what is your expectation for the number of deal completions by your company compared with the past year?



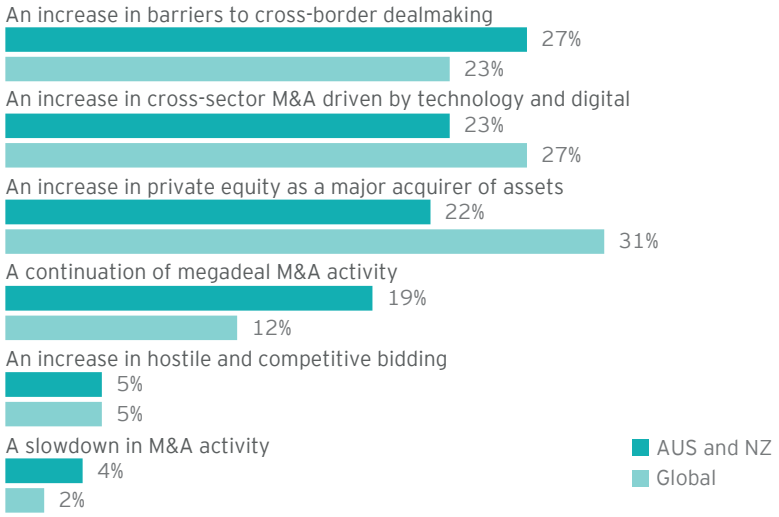
Dealmaking is being accelerated by the promise of entry into new markets

With dealmaking often the fastest route to new markets, and the cross-border dealmaking focus of local companies, it's no surprise that executives cite market entry as their prime (30%) M&A driver. Local dealmakers are more focused on cross-border transactions than their global counterparts (27% local; 23% global) and therefore also more concerned about the impact of increasing protectionist barriers.

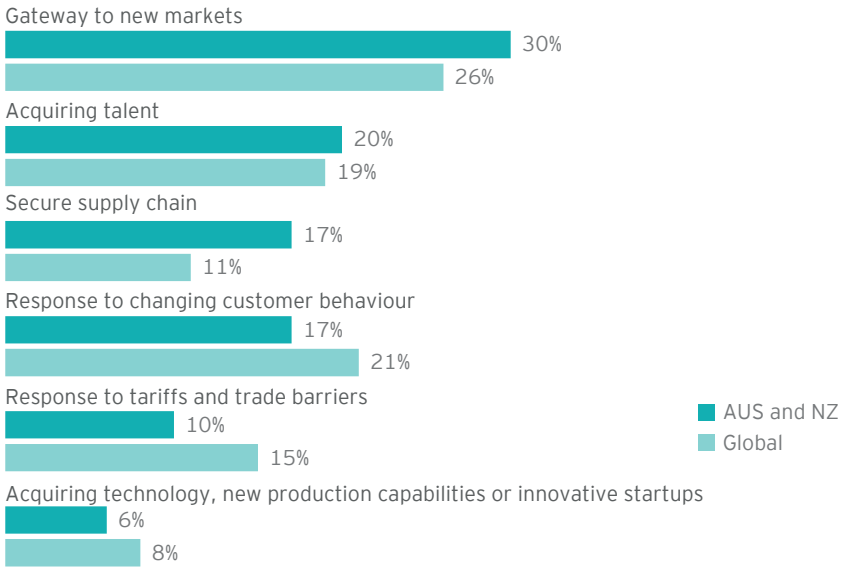
As trade barriers are erected, companies are planning more cross-border deals to mitigate the potential negative impact on their operations, secure market access and protect supply chains. To this point, the security of business supply chains is more of a priority for local executives than for their global peers (17% local; 11% global). Executives should remain agile in their approach to geopolitical disruption and be prepared to reimagine their global footprint.

For one in five, the main driver is acquiring talent. With tight labour markets across many economies, executives say that acquiring talent has now become a critical component of their M&A strategy.

Q What will be the main themes of M&A in the next 12 months?



Q What are the main strategic drivers for pursuing acquisitions?

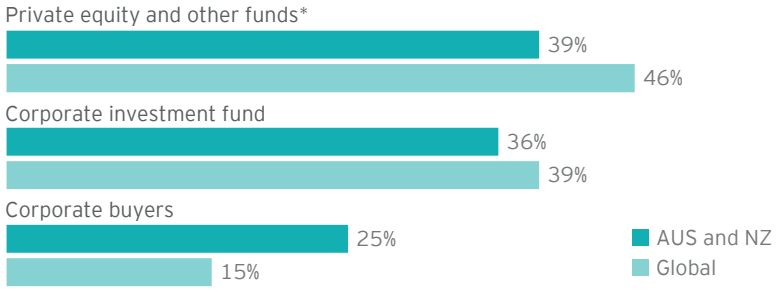


Are local executives underestimating future competition from private capital?

Local executives may be underestimating the competition from private equity (PE) and other funds. Although three-quarters of our respondents expect to see increasing competition for assets in the next 12 months, they see less coming from PE than their global peers (39% local; 46% global). They are more realistic about the likely increasing pressure for assets from venture capital, corporate venture capital funds, sovereign wealth funds and family offices.

With record levels of dry powder, we expect PE and other sources of private capital to be major buyers in M&A over the near term. This should enable corporates to widen the pool of potential buyers, even as it complicates acquisition strategies on the buy-side. Private capital is investing more and more for the medium and long term, returning to the M&A market with significant purchasing power. Corporate executives should be prepared for increased competition for assets – or be open to collaborating with PE on deals, especially when acquired assets may need to be divested to execute the deal.

Q Where will increasing competition for assets come from in the next 12 months?



*Includes venture capital, corporate venture capital funds, sovereign wealth funds and family offices

Top 6 sectors actively pursuing acquisitions in the next 12 months

Life Sciences is the top sector actively pursuing acquisitions as the importance of obtaining, analysing and managing data in-house grows and the push for digital and electronic health care information management in the sector continues.

Financial Services continues to be a hotbed of M&A activity. Previously, banks have looked to divest under-performing and (which are now considered) non-core businesses, such as life insurance and wealth management, which are no longer needed to distribute products to their customers. We expect this will continue as banks exit non-core assets and turn their focus to customers, the Australian Royal Commission drives future asset sales, and private equity's appetite to invest in financial services assets continues to grow.

The remaining top sectors pursing acquisitions are those where new technologies are beginning to shape future portfolios. For example, in response to the rise in demand for electronic vehicles (EVs) and battery storage, car manufacturers are developing EVs and investing in battery technology. Similarly, power and utilities companies are also exploring battery storage, as well as digital grid technologies.

1. **Life sciences**
2. **Financial services**
3. **Mining and metals**
4. **Industrials**
5. **Power and utilities**
6. **Automotive and transportation**

Top 5 investment destinations

Australasian companies are hedging their bets between relatively safe local investment destinations (Australia and New Zealand) and those embroiled in trade uncertainties (US, UK and China), suggesting those local companies planning deals are actively looking to get ahead of potential geopolitical disruption. Australian executives have the greatest appetite in the world for foreign investment in the US and China.

	Local companies		Global companies
1	Australia	1	United States
2	United States	2	United Kingdom
3	New Zealand	3	Canada
4	United Kingdom	4	Germany
5	China	5	France

The critical questions local executives should ask themselves to drive better M&A in today's deal economy.

A seasonal plan, or a plan for all seasons?

Executives know that risk is inherent in any economy. The question is whether the current risk landscape is a reflection of a cycle or something altogether new. Regardless, effective forward planning can insulate against these risks and provide opportunities for future growth.

Can you find the growth?

Global growth desynchronises while technology and demographics alter the global economic landscape. Advanced analytics and scenario planning, as part of portfolio and strategy reviews, can help companies more quickly identify the next hot spot for growth.

How can you find certainty in an uncertain regulatory environment?

Both antitrust/competition and broader industry regulations are shifting as industry ecosystems evolve. A better understanding of the new benchmarks and metrics being developed to regulate industries may give companies a competitive M&A advantage.

Public markets or private capital?

The rise of private capital, including private equity, super funds and corporate venture capital, has fundamentally reshaped the funding environment. Companies should consider which funding source best suits their needs now and the capital structure best suited for their future growth.

Is post-deal integration a pre-deal consideration?

Local companies that continue their M&A plans may apply a renewed focus on integration strategies as executives recognise the opportunity to achieve greater synergies. Increasing numbers of companies surveyed are starting their integration planning earlier after some achieved lower synergies than anticipated in their most recent deal.

How can you be more rigorous in your approach to identifying synergies?

Local companies are not being as aggressive at identifying synergies as their global counterparts. They should employ a bottom-up approach to calculate transaction synergies and hold management accountable to targets set with reasonable assumptions.

About the survey

The *Global Capital Confidence Barometer* gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY framework for strategically managing capital. It is a regular survey of senior executives from large companies around the world, conducted by Euromoney Institutional Investor Thought Leadership (EIITL). Our panel comprises select global EY clients and contacts and regular EIITL contributors.

- In August and September, we surveyed a panel of more than 2,600 executives in 45 countries; 68% were CEOs, CFOs and other C-level executives.
- Respondents represented 14 sectors, including financial services, consumer products and retail, technology, life sciences, automotive and transportation, oil and gas, power and utilities, mining and metals, advanced manufacturing, and real estate, hospitality and construction.
- Surveyed companies' annual global revenues were as follows: less than US$500m (25%); US$500m–US$999.9m (23%); US$1b–US$2.9b (21%); US$3b–US$4.9b (9%); and greater than US$5b (22%).
- Global company ownership was as follows: publicly listed (56%), privately owned (39%), family owned (2%) and government or state owned (3%).
- The Australasia report provides a snapshot of local findings from 170 executives from Australia and New Zealand in the context of Global results.

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