KPMG

M&A trends in the industrial manufacturing sector

A record-smashing year for IM as companies double down on digital

2021

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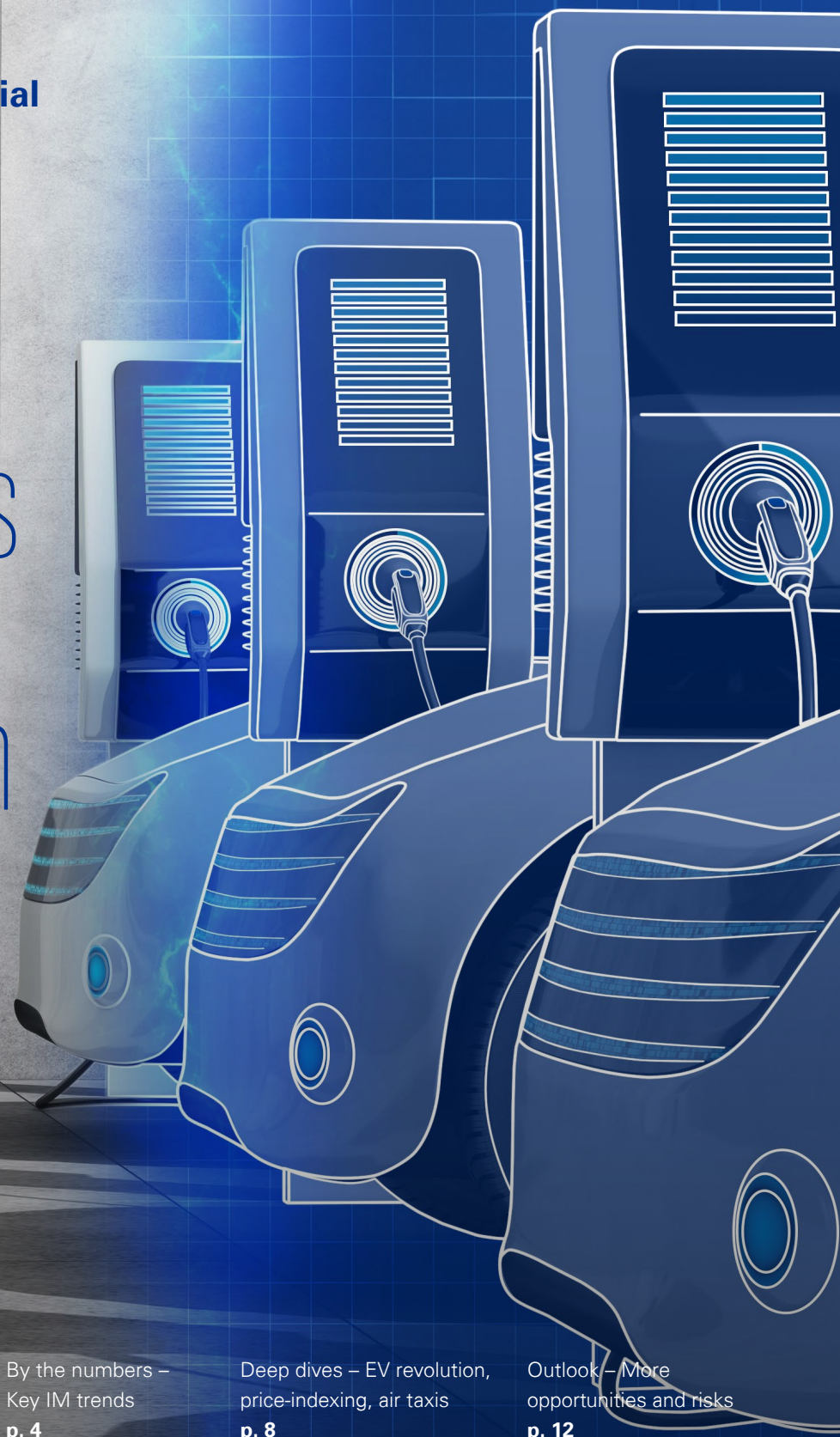


Introduction

M&A sets stage for sweeping change

Hectic M&A activity in the industrial and manufacturing sector is both a catalyst for, and a response to, massive change. Emerging from the COVID-19 recession of 2020, IM companies have doubled down on the adoption of disruptive technologies, such as electric and autonomous vehicles.

In many cases, the rationale for deal making has changed: from adding scale or gaining access to new customers, to finding fresh sources of growth in technologically disrupted spaces. A recent KPMG survey of M&A deal makers in manufacturing shows that, due to their higher multiples, 64 percent of companies are relying on more than just typical costs synergies and this is making it more complex to unlock value.[1]

M&A activity in IM soared to a new record of 10,173 deals worth $806 billion in 2021, 88 percent higher in value than in 2020 and 77 percent more than 2019.

Deal volume jumped 41 percent in 2021, and the average value of $79 million per deal in 2021 was 33 percent higher than in the previous year.

The frenetic pace continued through the year. Strategic deals even picked up speed in the fourth quarter, to end 2021 with a total volume of 6,129 deals, 42 percent higher than the year before.

PE deals were up 39 percent, reaching 3,981, versus 2,867 in 2020. Even SPAC deals were up for the year, despite slower activity in the second half. In all, 63 IM properties were acquired by SPACs in 2021, twice as many as in 2020. Their total value was $123 billion, more than triple the level of 2020. SPAC deals represented 15 percent of total M&A value in manufacturing in 2021.

Every IM sub-sector saw more deals in 2021 than in 2020. Automotive transactions rose almost 67 percent over the previous year, reaching a total value of $93 billion. These deals were driven by efforts to strengthen supply chains (for example, Dorman Products' acquisition of Dayton Parts[2]), and continuing investments in electric vehicles (for example, the purchase of Volvo's Polestar by Gores Guggenheim, a SPAC for $20 billion[3]).

Aerospace and defense (A&D) deal volume was up by a relatively subdued 29 percent, as civilian aviation struggled to recover from the pandemic.

In diversified industrials, there were 2,818 deals worth $204 billion, 50 percent more volume than in 2020. Diversification itself is open to question in these businesses: executives say they are more focused on core capabilities and divesting non-core businesses. The prime example: General Electric's November announcement that it is splitting into three companies that will focus on healthcare, aviation, and energy.

In the transportation subsector, average deal size was $255 million and was lifted by the $31.7 billion takeover of Kansas City Southern by Canadian Pacific Railway. This is the first major rail deal since the 1990s and creates the first rail network connecting Canada with the U.S. and Mexico.

Key statistics

$806B total value of IM M&A activity in 2021, 88 percent higher than 2020.

+33% change in average value of IM deal in 2021, at $79 million per deal.

63 IM properties acquired by SPACs in 2021, double the number in 2020.

+217% increase in deal value of automotive transactions in 2021.

In other areas of manufacturing, the most active subsectors were business services (4,433 deals) and building and construction (1,506). The average deal size here was less than $80 million.

Other notable deals included Parker-Hannifin's acquisition of Meggitt, a UK provider of aerospace and defense motion and control technologies, for $8.8 billion.

[1] Source: KPMG Annual Senior Executive M&A Survey, December 2021
[2] Source: Dorman Products, Inc. to acquire Dayton Parts, Dorman Products Inc. media release, GlobeNewswire, June 27, 2021
[3] Source: Adam Cieply et al, Automotive M&A is in top gear, M&A Explorer, 9 November, 2021

Standard Industries acquired W R Grace & Co in a $6.7 billion deal announced in April, and Emerson Electric acquired Aspen Technology for $11 billion.

We believe the following trends will drive healthy IM deal activity in 2022:

— Supply chains have become huge bottlenecks, resulting in shortages of all kinds of materials and components. Such shortages have pushed up prices and are not expected to ease dramatically this year. Therefore, we anticipate a surge in M&A around component suppliers in 2022, especially in aerospace. Overall, Tier 1, 2 and 3 subsectors are likely to consolidate further.

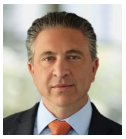
— The electrification of cars, and the resulting reduction in the number of components per car, will have a profound effect on automotive suppliers. Many may have to acquire or sell assets if they are to survive.

— President Biden's infrastructure spending bill, passed in November 2021, will lift industries involved in roads, bridges, tunnels, and other infrastructure sectors. This will benefit construction, engineering, equipment, and automobile manufacturing, and is likely to speed up consolidation in their supply chains.

— Portfolio optimizations will lead to further restructuring among manufacturers, especially for diversified industrials such as 3M and Berkshire Hathaway.

— SPACs are favored by entrepreneurs as a fast way to go public in new emerging industries such as commercial space (Virgin Galactic), EVs (Lucid), and electric vertical takeoff and landing (eVTOL) aircraft (Joby and Archer).

Looking ahead, IM deal makers will be closely observing the implications for M&A of the expected rise in interest rates and the trajectory of inflation. Supply-chain woes are not predicted to dissipate any time soon, and this will affect the timing and selection of M&A deals among suppliers.



Donald Zambarano
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By the numbers

Strong activity across subsectors

2021 was a bumper year for IM deal makers as the pandemic continued to accelerate digital transformation and the global economy started to recover from COVID-19's effects.

M&A activity was frenetic throughout the year, although strategic and SPAC deal making slowed somewhat in Q4'21. PE deals, by contrast, soared in value in the fourth quarter, helping increase deal value by 88 percent for the year. Strategic deals totaled $362 billion, 69 percent more than in the previous year, while SPAC deals were worth a total of $123 billion, up 240 percent (together representing $485 billion in value).

Air travel partially recovered from a 60 percent drop in global flights in 2020, and deal making in A&D moved into high gear. M&A value doubled in 2021. Deal value also doubled in the building and construction subsector. Increases were even greater in the automotive industry (217 percent) and in transportation and logistics (a more than sixfold rise).

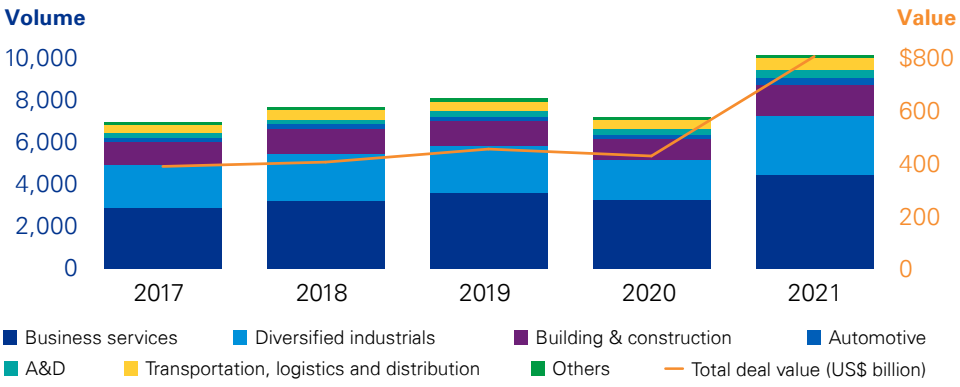
The value of M&A in diversified industrials rose by 43 percent to $204 billion, the largest subsector rise in dollar terms. There's likely to be much more consolidation in 2022, as companies concentrate on core capabilities and optimize their product portfolios.

Cross-border deals composed a slightly smaller proportion of deal volume than previously, largely due to a reduction in the number of outbound deals (U.S. companies acquiring non-U.S. assets). In 2021, 15 percent of M&A deals were outbound, compared to 10 percent inbound.

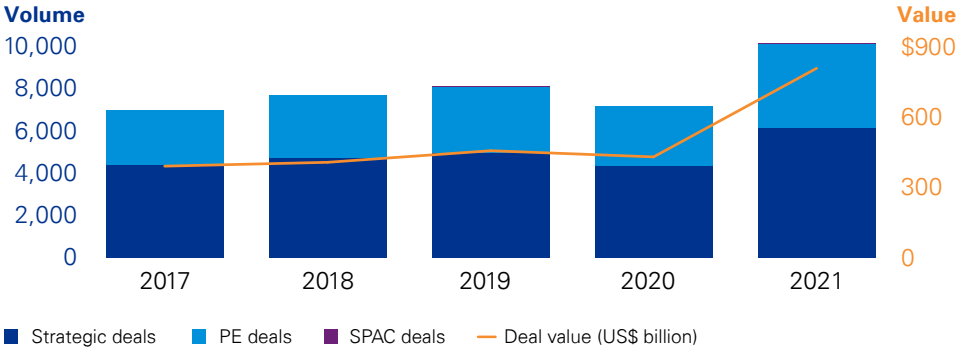
Top IM deals in 2021

Acquirer	Target	Value (billions)
Canadian Pacific Railway	Kansas City Southern	$31.7
Gores Guggenheim, Inc.	Polestar Performance AB	$20.0
Australian Super, IFM, etc.	Sydney Airport	$17.2
Churchhill Capital	Lucid Group, Inc.	$11.8

U.S. IM activity by sector



Strategic, PE, and SPAC TMT deals



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

By the numbers

Automotive M&A trends:

M&A set to fuel dramatic changes

Deal volume and value in the automotive sector soared in 2021—particularly in Q4'21. The number of deals totaled 317, two-thirds greater than in 2020, with value totaling $93 billion, almost double the previous two years' tallies.

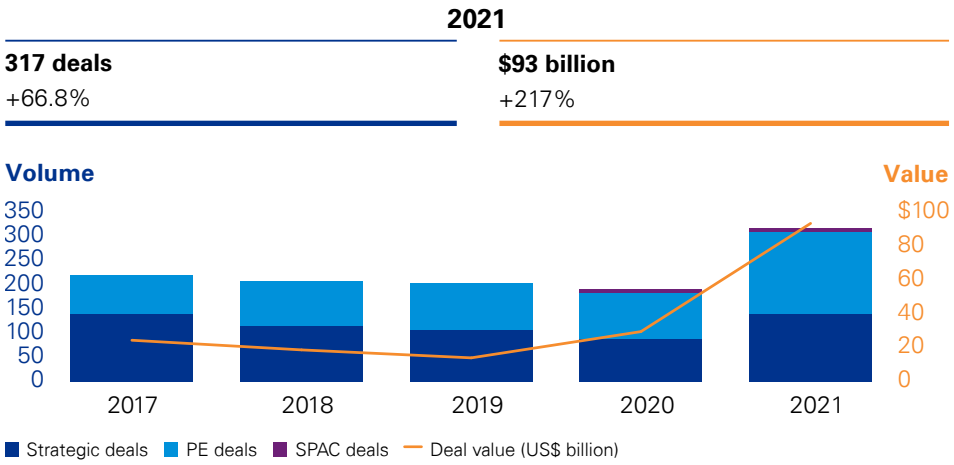
Several factors are driving M&A activity. Auto makers struggle to secure key components such as semiconductors and one way for manufacturers to strengthen supply chains is to acquire or invest in important suppliers. A shift in demand from internal combustion engines to EVs is also shaking up suppliers, in part because EVs need significantly fewer components. Automakers are investing heavily in battery production, such as Ford and SK's $11.4 billion plan to build plants in Tennessee and Kentucky.

A new KPMG survey shows that about half of Tier 1, 2, and 3 suppliers expect to divest parts of their business in the next several years.[4] The digitization of auto manufacture means original equipment manufacturers (OEMs) need technology skills, encouraging them to buy companies with special expertise in areas such as custom semiconductor design.

PE firms were particularly important in 2021, completing more than half of all automotive M&A deals and accounting for 41 percent of total deal value. Among the most significant: An investor group that included Ares Capital acquired Mavis Tire Supply.

Strategic M&A deal value doubled and deal volume grew 61 percent; more than a third of transactions were cross-border.

Automotive deal value and volume



Top automotive deals in 2021

Acquirer	Target	Value (billions)
Gores Guggenheim, Inc.	Polestar Performance AB	$20.0
Churchill Capital Corp.	Lucid Group, Inc.	$11.8
Blackstone Group, Macquarie, etc.	Autostrade per l'Italia	$11.3

Notable deals included Qualcomm's $4.5 billion acquisition of Swedish auto electronics company Veoneer, which strengthened Qualcomm's position in advanced driver-assistance systems.

SPAC deals were less prominent in automotive than in other manufacturing industries, but they did include EV-maker Lucid's acquisition of Churchill Capital Corp IV for $11.8 billion in February. There were eight automotive SPAC deals, the same number as in 2020, but with a 182 percent increase in total value to $39 billion.

ESG was a burgeoning theme of automotive M&A as manufacturers prepared to make themselves compliant with anticipated regulations. For example, Cognizant acquired ESG Mobility in March 2021 to expand its automotive engineering capabilities, especially for connected vehicles.[5]

Given these trends, it is likely that M&A activity in the automotive subsector will continue to accelerate in the coming months and years.

[4] Source: KPMG Global Automotive Executive Survey 2021
[5] Source: "Baker McKenzie advises Cognizant on acquisition of ESG Mobility", Baker McKenzie, March 30, 2021

By the numbers

A&D M&A trends:

Geopolitics and economic recovery will shape 2022

M&A activity in aerospace and defense (A&D) rose sharply in 2021: there were 351 deals, exceeding both 2019 and 2020 by more than 20 percent. However, the total deal value of $63 billion, while double that of the year before, was $46 billion less than 2019.

Positive M&A trends in the sector are expected to continue in 2022. If the global economy recovers further from the pandemic, and air travel regains momentum, aerospace M&A is likely to see a strong year. Geopolitical factors will play a significant part in this, as big-power rivalry tends to lead to more military spending, creating a fertile terrain for M&A domestically and across borders.[6]

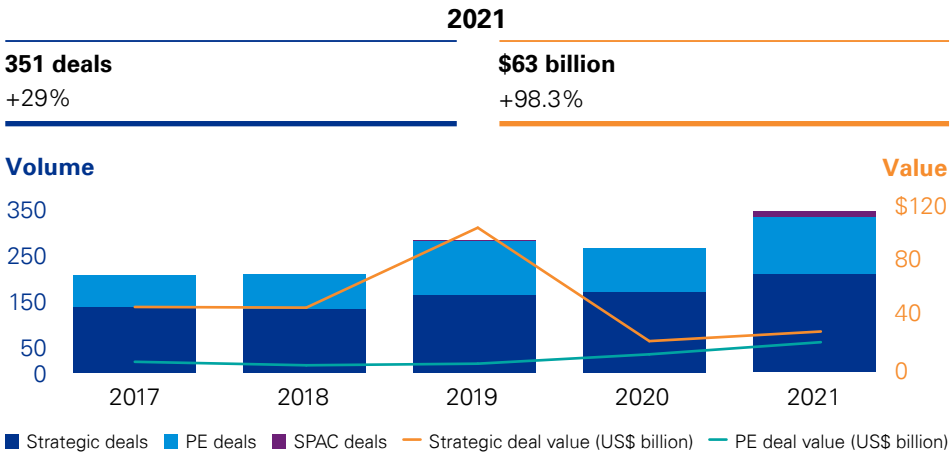
Civilian aerospace M&A activity began to warm up in the second half of 2021, as financially strong aerospace companies began acquiring smaller companies with balance sheets stretched by the impact of COVID-19; this trend is likely to accelerate in 2022. Civilian suppliers are diversifying their portfolios by acquiring companies that focus on defense, or those that operate outside A&D in areas such as medical equipment and semiconductors. Aviation data and analytics is another area of interest: in August, Collins Aerospace, a Raytheon business, acquired privately held FlightAware for an undisclosed sum.

Subsectors attracting M&A interest include space technology, unmanned aerial vehicles (around 20 transactions), as well as services and technology in command, control, communications, computers, intelligence, surveillance, and reconnaissance. In January 2022, Blue Origin acquired Honeybee Robotics, which makes tools for space probes. In May 2021, Peraton, a mission-support tech firm backed by PE firm Veritas, bought enterprise-information company Perspecta for $7.1 billion. Veritas also acquired Cubic, a provider of tracking technology, in March for $3 billion. PE interest is also growing in aviation manufacturers that are well positioned to capitalize on a recovery in travel demand.

For the first time, SPAC deals have become an important feature of A&D industries, as new entrants in commercial space ventures and eVTOL aircraft manufacturing seek funding. In December, Embraer's Eve, a urban air mobility business, acquired Zanite, a SPAC, in a deal valuing the company at $2.9 billion.

SPACs are seen as attractive ways to access public-equity markets by many other space and satellite companies—including Redwire, Wheels Up, Astra, Planet, Satellogic, Virgin Orbit, and Terran Orbital. Among the areas that saw SPAC activity were rocket launching, satellite orbit positioning, and geospatial imagery.[6] In 2021, there were 11 SPAC deals worth a total of $15.5 billion in this subsector, compared with only one in 2020 and three the previous year, demonstrating the power of this trend.

Aerospace and defense deal value and volume



Top aerospace deals in 2021

Acquirer	Target	Value (billions)
Parker-Hannifin Corp	Meggitt Plc	$8.8
Peraton Corp	Perspecta Inc.	$7.1
Elliot Management	Cubic	$2.8
Amentum Gov Services	PAE Inc	$1.9

[6] Source: "Future of M&A in aerospace & defense", KPMG International, 2021

By the numbers

SPAC M&A trends:

Deals spanning an array of industries

The number of SPAC deals in IM almost doubled in 2021 and the dollar value almost tripled. Attention was focused on SPAC activity in areas where new entrants were gaining a foothold, such as EVs, eVTOL aircraft, and commercial space companies.

Among the most noteworthy SPAC deals in any industry was Lucid Motors' merger with Churchill Capital IV for $11.8 billion, announced in February 2021. Lucid is planning to take on Tesla at the top of the luxury electric-car market, sell cars in Europe this year, and build an EV factory in oil-rich Saudi Arabia in 2026. Rival Rivian took the more conventional route in November with one of the biggest IPOs ever.

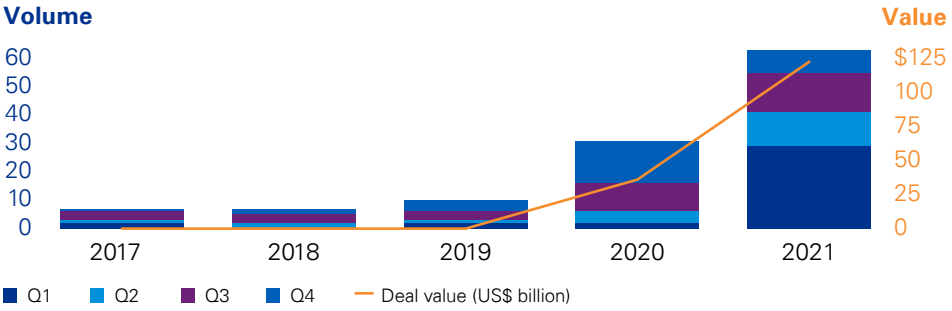
There were a dozen SPAC deals in the space sector, including the acquisition of Richard Branson's Virgin Orbit. However, SPAC activity declined as the year progressed, as players reassessed the readiness of certain companies to go public.

SPAC deal value and volume

2021

63 deals
+103%

$122.7 billion
+240%



Top SPAC deals in 2021

Acquirer	Target	Value (billions)
Gores Guggenheim, Inc.	Polestar Performance AB	$20.0
Lucid	Churchill Capital IV	$11.8
Joby Aviation	Reinvent Technology	$4.5

By the numbers

PE M&A trends:

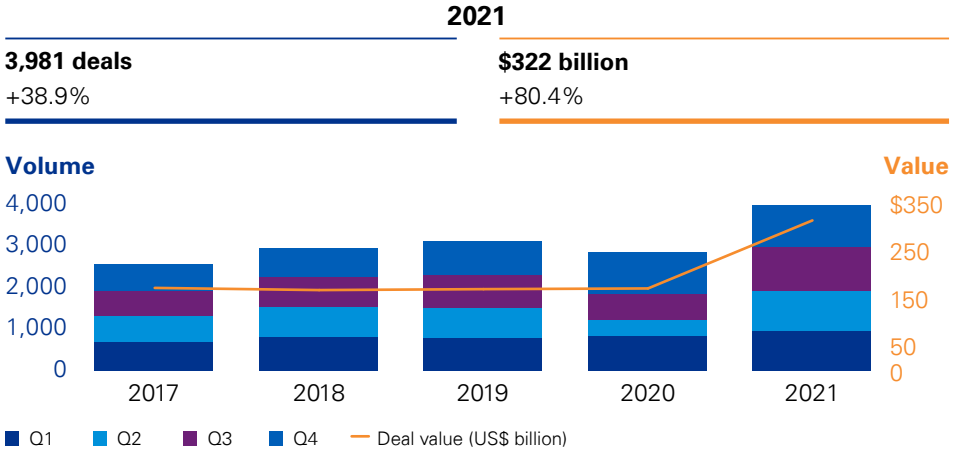
Private equity's big role

Unlike strategic and SPAC deals, which slowed in the fourth quarter, PE deal volume remained high throughout the year. There were 992 transactions in Q4'21 alone, about the same as the previous three quarters. With a combined deal value of $109 billion, more than double the first quarter. In 2021 overall, PE deal value totaled $322 billion, almost twice the value of the previous year. As in 2020, PE deals composed nearly 40 percent of all M&A activity in the sector.

Among the most sizable PE deals were ones involving infrastructure-related businesses, such as Sydney airport and Italy's major toll-road company, Autostrade per l'Italia. A consortium led by Bain Capital acquired Hitachi Metals for $7.3 billion. PE firms were particularly active in business services, building and construction, and diversified industrials. There were almost 300 PE deals in A&D and autos, worth a total of $58 billion, in 2021.

PE firms are currently particularly interested in deals involving EVs, autonomous vehicles, and other mobility technologies. They are also alert to buying and selling opportunities that arise when manufacturers optimize their portfolios--particularly underperforming makers of components for internal-combustion engines. As autos and A&D continue to restructure in 2022, PE firms are expected to play an active role in finding deals that fit these trends.

PE deal volume and value



Top IM PE deals in 2021

Acquirer	Target	Value (billions)
Macquarrie	Autostrade per l'Italia	$11.3
Bain Capital	Hitachi Metals	$7.3
Blackstone	Home Partners of America	$6.0
Ares	Mavis Tire Supply	$6.0

The EV revolution:

Will the U.S. infrastructure bill jump-start the EV charging market?

The transition to battery-electric vehicles (BEVs) received a significant boost in November with the passing of the $1 trillion-plus U.S. infrastructure bill. The package earmarks $7.5 billion for the creation of a nationwide network of 500,000 public vehicle-charging points by 2030. This will help to quell the "range anxiety" that has limited the appeal of BEVs among new car buyers—with inadequate, slow charging widely believed to be the largest deterrent to adoption.

The U.S. has just 4 percent of the charging stations it will need by 2040 to meet anticipated EV demands.

The federal commitment may act as a green light for investment in the charging business, which has been held back by, until now, low BEV sales. Now, with this chicken-and-egg standoff coming to an end, we may see a flurry of M&A activity as the EV-charging business finally takes off. It is estimated that the U.S. has just 4 percent of the charging stations it will need by 2040 to meet anticipated EV demands, creating substantial business opportunities in this space. It will take investments of between $22 billion and $35 billion to build charging infrastructure across U.S. metropolitan areas.[7]

The BEV-charging market consists of three major segments: public charging stations, used by drivers while traveling or if they don't have a charging facility at home; in-depot captive charging stations for fleets; and home-charging ports, used while a car is parked at a residence. All three markets are poised for rapid growth, in line with a predicted increase in BEV sales. Automotive executives expect BEVs to compose half the auto market in the U.S., China, Japan, and Western Europe by 2030.[8]

Given the rapid evolution of BEV technology, interested companies should accelerate their plans to enter the market for charging—while also carefully strategizing and weighing their options. Many may join forces to earn a return on investment: several players are already forming corporate alliances to share resources and lower risk.

Some auto makers are considering direct investments in charging infrastructure: for example, Electrify America, owned by VW Group, is looking to spend $2 billion on BEV-charging projects. Oil companies have gas stations that could be used for charging, while utilities companies see an opportunity to grow revenue in this market, too. PG&E has plans to install 7,500 chargers at apartment buildings and workplaces across California, for instance.

There are many start-ups entering the market with different products, from infrastructure to charging hardware. ChargePoint, a leader in so-called Level 2 installations, which cost less than $1,000 per unit and are used as home-charging ports, has received funding from energy giant Chevron. Other relevant start-ups include EVgo, Blink, and EVBox.

In the first half of 2021, approximately 13 EV-related SPACs were completed, raising $7.5 billion for BEV makers and companies involved in charging. There were several more SPAC deals in the second half of the year, including Tritium and Volta.[9] In October, Wallbox merged with SPAC Kensington Capital Acquisition, raising around $330 million, including a $100 million fully committed private investment in public equity (PIPE), anchored by Janus Henderson Investors, Luxor Capital, Cathay Innovation, and Kensington Capital Partners.[10] In addition, several companies have been acquired by oil firms or funded by them, such as BP's recent acquisition of EV fleet-charging provider AMPLY Power.

Many more M&A deals are likely to follow as EVs move into higher gear. It promises to be a rich market for investors as government infrastructure spending ramps up in the years ahead.

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Managing Director
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[7] Source: KPMG internal report: EV landscape preliminary research
[8] Source: KPMG, 22nd Global Automotive Executive Survey 2021, Industry leaders foresee dramatic changes
[9] Source: "Colin McKerracher, Hyperdrive Daily: The EV SPAC boom could have been even bigger", Blooomberg.com, July 6, 2021
[10] Source: "Smart charging and energy solutions provider Wallbox to list on NYSE through merger with Kensington Capital Acquisition Corp. II, Kensington Capital Acquisition Corp. II" media release, June 09, 2021

Due diligence:

Examine your target's price-index contracts

Today's supply chain is an important part of a manufacturer's value, and should be a focus of any careful M&A due-diligence process. Now that inflation has heated up, one aspect that merits scrutiny is a target company's price-index agreements.

Price-index agreements are used by vendors to prevent their margins from being eaten by unexpected price spikes. Sometimes, a company will develop a web of such agreements. In one recent deal involving the acquisition of a contract parts manufacturer in Asia, the target company's entire value chain was indexed to the price of key materials; their third-party logistics provider's charges were indexed to labor and freight costs; while the U.S.-based final assembly was cost-plus based, and indexed to the assembler's invoiced prices.

In normal times, such contracts do not require much scrutiny, but when supply-chain costs are so volatile, these agreements can have a major impact on a target company's profit margin—whether they stay in place after M&A, are broken, or renegotiated.

Indexing basics

Writing a price-index contract is a game with two sides. A supplier wants to offload as much risk as possible, whereas a buyer wants to pay no more than what it has paid before. Indexing agreements can be particularly risky for the buyer and the price-index contract should be written in a way that keeps suppliers healthy, but not so they profit at the buyer's expense. Such details can be easily overlooked in the heat of an M&A negotiation.

In the due-diligence process, every price agreement should be reviewed with three questions in mind. Firstly, does the supplier have a legitimate case for indexing? This type of agreement is intended either to minimize the target's supply-chain risk, or to help stabilize a partner's costs. It should cover only materials that constitute a high proportion of the target company's cost of goods bought and sold.

Secondly, how much of the indexed material does the buyer need? Often, the amount of raw materials actually used in a component is only a portion of the purchase. Be aware, too, that for some materials, such as aluminum from scrap metal, production surcharges may be separate from the cost of the material itself. Sometimes, the prices of the material and the surcharge may even move in opposite directions.

And thirdly, is the contract appropriate for the situation? There are four basic types of index contracts to choose from:

- Fixed-price contracts are agreements where the price is held constant throughout the contract, even if there is a change in the underlying cost of the input. This protects against price fluctuations, but its rigidity can make it expensive and constraining.
- Floating-market-price index contracts fluctuate with the underlying input costs. This eliminates mispricing but gives little protection against extreme price spikes.
- Straight-collar index contracts allow the price to move freely within a fixed band (e.g., plus or minus three percent), but freezes the price if the seller's cost goes above or below that band. This buffers against extreme cost spikes, although the price can still change rapidly.
- Adjustable-collar index contracts allow the price to go up and down within a moveable band, but the final parameters can be reset by mutual agreement. This reduces the risk of mispricing and volatility but can be cumbersome to implement.

Cost-indexing agreements are a powerful tool for managing price volatility, but like any tool, they are useful only in certain contexts.

There is also a risk they may be broken at the precise moment they are most needed. After all, price pressure can't be eliminated, only reallocated; at some point, it will be felt in the system. Before making a purchase, it's a good idea for the buyer to understand where and when those points might be at the target company.

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Air taxis cleared for takeoff:

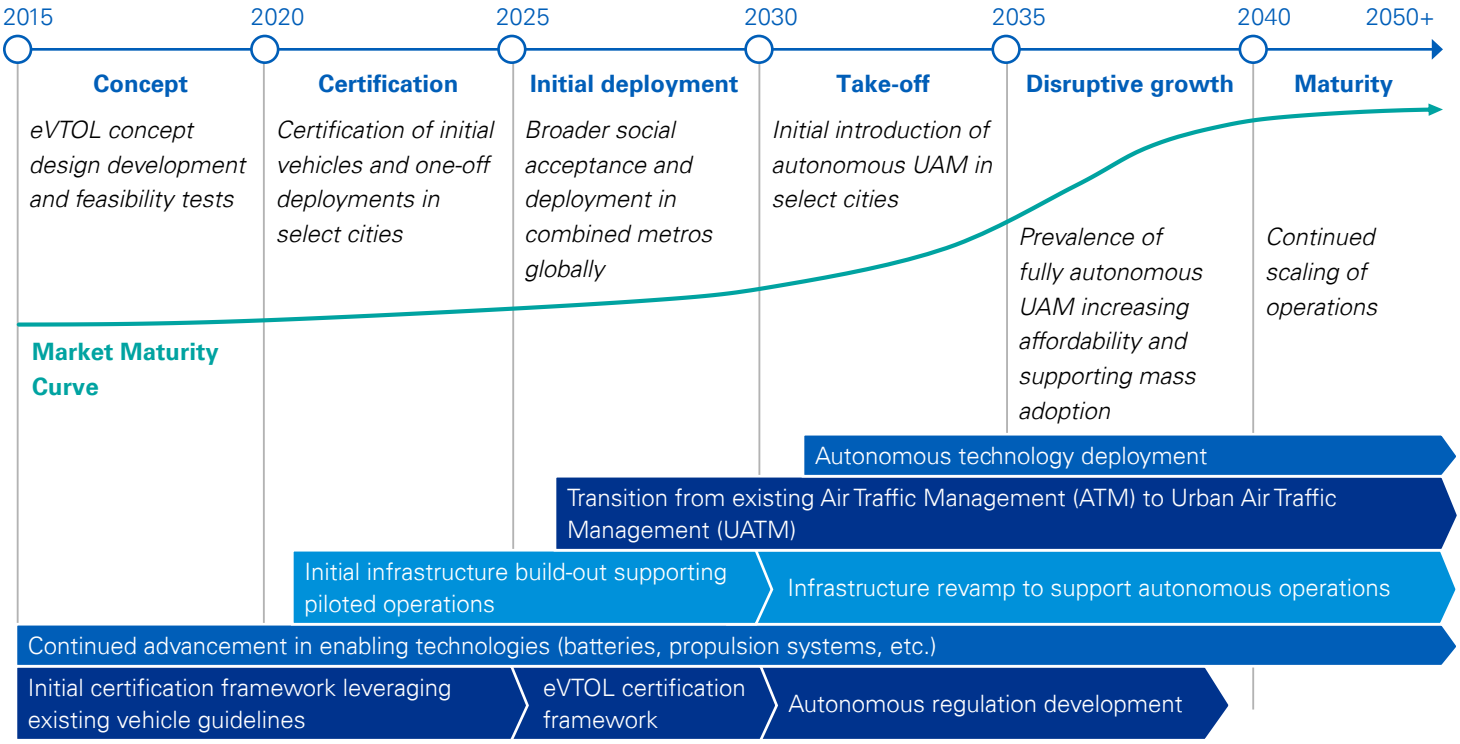
Early investors are bolstering urban air mobility

Air taxis may still be a decade away—but investors and deal makers are already vying for a share of the market.

Much as the internet disrupted retail, urban air mobility (UAM) looks poised to be a rare growth opportunity for aerospace manufacturers. KPMG forecasts that demand in the global UAM market could grow by 18 percent a year, to $119 billion by 2040—promising rich rewards for early and patient investors.[11] There are four segments where M&A is expected to play out: vehicle manufacturing, passenger operations, urban air-traffic management, and service and support.

M&A transactions have been small to date but promise to grow over the

UAM is expected to mature over the next 20 years; autonomy will be critical in driving mass adoption



UAM estimated market over time – figures below represent end-of-phase values

					Total: (2025-40)
Passenger demand	29M	105M	261M	822M	**3.9B**
Units in operation	2K	19K	51K	106K	–
Total annual vehicles sold	2K	6K	12K	25K	**147K**
Market size ($)	$10B	$31B	$58B	$119B	**$762B**
eVTOL OEM Investment ($)	>$8B				

Source: Market for Urban Air Mobility, KPMG, June 2021

[11] Source: Market for Urban Air Mobility, KPMG, June 2021

next five years, as the technology for light, electric aircraft moves closer to commercialization. Manufacturers and operators in this new industry have already moved beyond the conceptual stage and are now seeking certification of prototype vehicles. Initial deployment is anticipated in 2025, with the development of autonomous vehicles achieved by the turn of the decade. Rapid growth of the market is expected in the late 2030s.

Research and development have, thus far, focused on eVTOL vehicles with various wing and rotor configurations—all meant to supersede helicopters and small aircraft in terms of cost, noise abatement, and safety.[12]

Boeing and Hyundai are among the large, established manufacturers that are developing UAM solutions. But aerospace companies do not have a monopoly on this market: auto makers have been entering the fray, as there are partial overlaps with the EV sector. However, eVTOLs present challenges for both industry participants: production is likely to run in the thousands of units—much more than in aerospace, but much less than what auto makers are used to. Technical, regulatory, and safety specifications will be as rigorous as for commercial flight operations.

In these early stages, much of the M&A focus is likely to be in manufacturing —although, for example, in December 2021, Eve, a UAM business created by Embraer S.A., announced that it would form a business combination with Zanite Acquisition Corp, developing air-mobility solutions that would include service and support, fleet operations, air-traffic management, and vehicle production.[13]

There are more than 100 companies designing and making eVTOLs. Many of these firms will merge or be taken over by larger manufacturers entering this market. Some of the leading OEMs in the field—Joby Aviation and Archer of the U.S., Lilium of Germany—have partnered with either automotive or aerospace companies. They are also publicly traded. In August 2021, Joby merged with Reinvent Technology Partners in a deal that generated $1.6 billion in cash, putting the company's post-money valuation at $6.6 billion.[14] Archer Aviation merged with Atlas Crest Investment for $858 million,[15] and Lilium merged with a SPAC Qell Acquisition Corp. to raise $584 million in gross proceeds.[16]

Other companies are likely to merge with SPACs, as manufacturing gathers pace and players seek to raise billions in capital funding. With many eyes on this new market, deal makers with deep pockets are likely to be rewarded by careful, thorough preparation and quick reflexes.

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Jim Adams
Principal
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[12] Source: Getting mobility off the ground, KPMG U.S. 2019.
[13] Source: Eve, an Embraer company, to List on NYSE Through Business Combination with Zanite Acquisition Corp., Eve media release, December 21, 2021.
[14] Source: Brian Garrett-Glaser, "Joby Aviation raises $1.6 billion in SPAC merger at $6.6 billion valuation," evtol.com, February 24, 2021.
[15] Source: "Archer Aviation Announces Closing of Business Combination with Atlas Crest Investment Corp. to Become A Publicly Traded Company", Archer Aviation, September 16, 2021
[16] Source: "Lilium closes business combination with Qell Acquisition Corp., will begin trading on Nasdaq under the symbol "LILM" on September 15", prnewswire.com, September 14, 2021.

Outlook

More opportunities in a mixed picture

It will be difficult this year for IM dealmakers to match 2021's torrid pace, but not impossible. Demand for deals was pent up after the pandemic first struck, and there is more work to do. The KPMG M&A survey showed that 61 percent of IM executives say they plan to step up their M&A activities in 2022. The appetite for deals, 64 percent say, is greater than before the pandemic, due to greater competition and the availability of cash. Companies will cost more to buy this year than last, say 86 percent of executives.

This means companies will need to extract more value out of mergers, and transactions will grow more complicated, as dealmakers look for new ways to justify paying higher prices. What is more, the M&A environment may be volatile, even treacherous. Economic news is likely to be dominated by government efforts to tame inflationary concerns, mostly by means of monetary policy, and this is bound to affect every financial transaction. The Fed has indicated that the market can expect a series of interest rate increases, starting in March. We may be entering a new era, after four decades of low inflation and mostly easy credit.

Political news will also enter the deal calculations. There is growing tension between Russia and the West and between China and the U.S. This may unsettle investors, throwing billions on the board, especially in defense industries. Contrarians may be more active, both before and after any market correction.

> While the macroeconomic picture seems highly unpredictable, the micro trends we've seen driving M&A will continue—and possibly speed up.

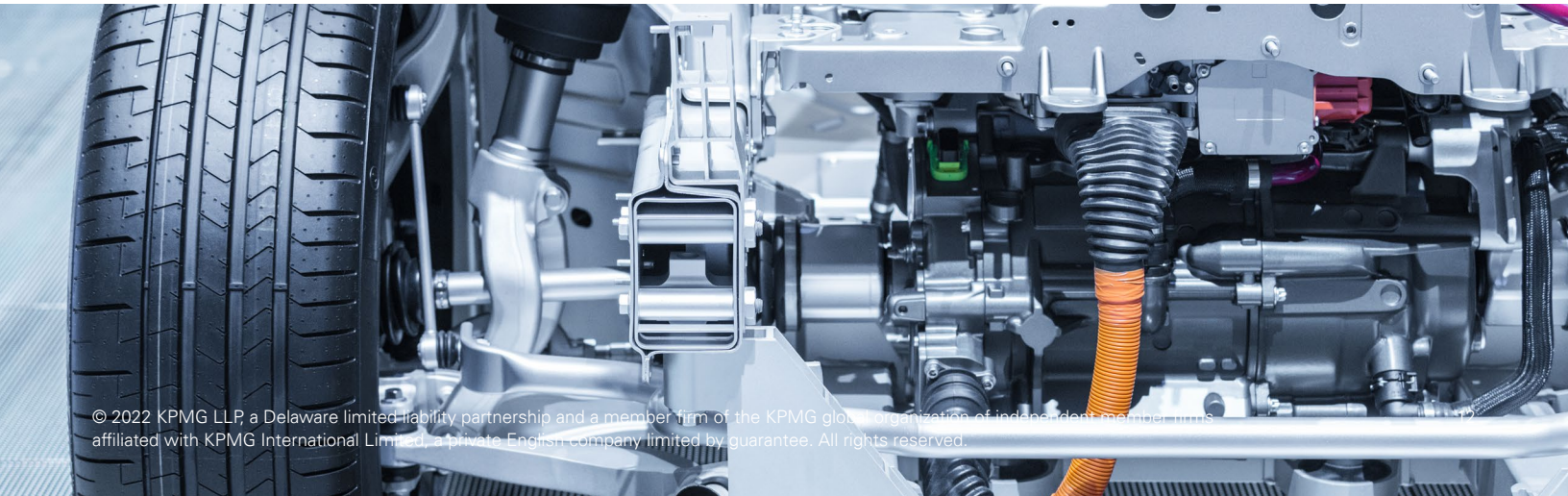
Digital transformation makes more sense than ever. Labor costs are rising, employees are resigning, suppliers can't supply, and skills are (as ever) hard to attract. Technology investments are one answer, M&A is another. It can sometimes be easier to buy a company with the requisite capabilities than to build it.

A merger wave among suppliers didn't occur in 2021 but may well do so this year. Diversified industrials are among the most vulnerable at a time when supply chains are under intense pressure and disruptors are looking for easy ways to enter rapidly transforming sectors.

Industrial conglomerates also suffer from a diversification discount, which has helped convince GE, Hitachi, and Toshiba to split themselves up (See "Can your valuation be improved?" KPMG 2018). Many others will surely follow.

But conglomerates are not the only ones narrowing their focus: there could be an intense shakeout among suppliers of both aerospace and automotive parts, as the electrification of drivetrains transforms the production process and drastically reduces the number of components.

There is no sign yet that the stress on supply chains will lessen, especially in semiconductors, so manufacturers will have to redouble their efforts to optimize their product portfolio. Competition will only intensify, because an even more powerful trend has just begun: the convergence of the technology and manufacturing industries. The automotive sector is leading the way, as cars become computers on wheels, but other sectors will surely follow, such as air taxis, drones, and intelligent appliances. Alphabet, Apple, and Amazon are all betting big on autonomous vehicles.



Key considerations as we look ahead

We continue to emphasize four priorities for deal makers to succeed in this environment:

1

Explore the bifurcation: The IM sector is split between high-growth businesses and low- or negative-growth ones. The gap may grow if consumers shift their focus from manufactured goods to services. Both high- and low-growth companies present opportunities for those seeking to optimize portfolios, in which bargains may be hidden behind a financial picture that may seem either too rosy or too dire.

2

More disruptors than ever: Manufacturer's adoption of disruptive technologies is perhaps the biggest M&A theme going forward. Ensure your company's M&A strategy is aligned with its digitization strategy. When and where does it make sense to defend, and when to attack? Nobody wants to be a sitting duck for a disruptor.

3

The industry is increasingly unpredictable: To avoid being frozen by indecision, companies can explore the options for their market segment, considering both positive and negative deal-making scenarios. From Tier 1 to 3, which suppliers may come to your company seeking financial assistance? Why wait for the knock at the door? What unwanted assets in your company's portfolio are likely to fetch the highest price in 2022? How much dry powder do you have, and how should you use it?

4

A macro environment full of challenges and opportunities: The economic recovery from the pandemic enters a new phase in 2022, marked by inflationary pressure, the prospect of rising interest rates, and the possibility of a stock market correction. Add in an increasingly fraught geopolitical situation and there are the makings of a significant shakeout among dealmakers. Be sure the balance sheet is strong enough to withstand upcoming shocks.

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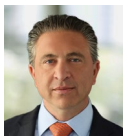

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