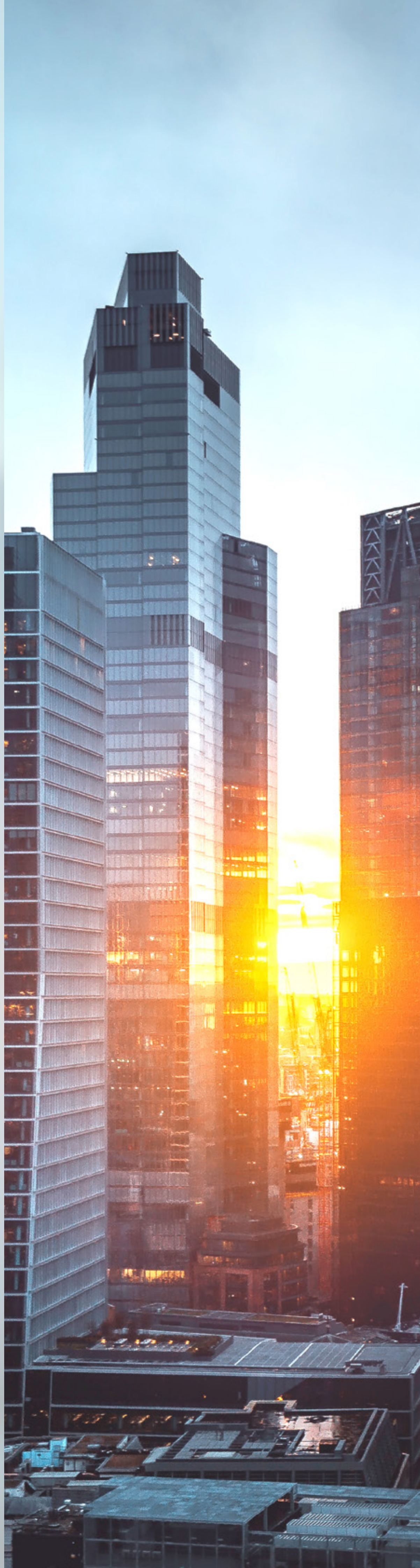
AON

M&A Risk in Review

1H, 2023



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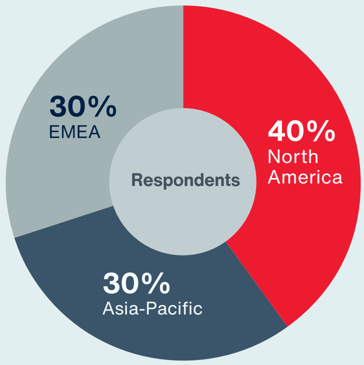
Methodology

In Q1 2023, Mergermarket surveyed 50 senior executives from corporate development teams, private equity firms, and investment banks. 40% of respondents were based in North America, 30% in EMEA, and 30% in Asia-Pacific. The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone by appointment. Results were analyzed and collated by Mergermarket. All responses are anonymized and presented in aggregate.



Introduction

Dealmaking conditions are undeniably tough. Between macroeconomic volatility, market dislocation, challenging financing conditions and increasingly strict regulatory scrutiny, it seems more difficult than ever to get a transaction over the line.

And yet, respondents to our survey are ready to wade into these desperate straits, forecasting an increase in M&A activity over the next 12 months. Even in a down market, there are deals to be had, propelled by underlying, long-term trends. None are more important, it seems, than digital transformation, which is providing a spur to dealmaking in the Technology, Media and Telecom (TMT) sector, and Environmental, Social and Governance (ESG) factors' rapid ascent up public policy and, subsequently, corporate agendas.

In 2022, the number of transactions in which Aon provided advisory services and/or transaction solutions topped 2,600. This number comes in after 2021's historic deal volume and is more consistent with pre-COVID deal volumes. In the transaction solutions space, Aon secured more than $41 billion of insurance for its clients' M&A risks around the world. While representations & warranties (R&W)/ warranty & indemnity (W&I) insurance remains the most prolific, both tax and litigation insurance represent an important and growing tool in clients' arsenals, with litigation posting a record year of activity and tax poised to continue to help clients take advantage of investment opportunities, in particular those fueled by the Inflation Reduction Act (IRA).

In 1H 2023, Aon provided transaction advisory and/ or transaction insurance solutions on more than 1,300 deals, with approximately 460 deals based in the US. This shows a decline of 11% in deal volume in first half of 2023 from the same period in 2022 and a decline of 35% from the volume highs in 2021. Aon does expect to see deal volume in 2H 2023 in line with historical activity and due to a number of factors, including increased investment in renewable energy projects and infrastructure following the Inflation Reduction Act of 2022, carve-out activity and historic levels of dry powder at private equity firms.

According to Mergermarket figures, 8,842 M&A deals were announced globally in Q2 2023, representing a 15.3% decline quarter on quarter. However, the aggregate value of those deals was up on the first three months of the year, rising 22.6% from $663.7 billion in Q1 to $813.4 billion in Q2. Regarding acquisitions of US companies specifically, volume was likewise down quarter on quarter (2,526 deals in Q2, versus 3,058 in Q1), while total value was up 18.8% to $339.9 billion from $286.2 billion over the same period.

Evidently, opportunities are available for prudent investors who are able to capitalize on current conditions and as the market convalesces.

Key takeaways from the report

1

Continuing the trend observed over the last few years, the largest share of survey respondents, 68%, identify TMT as likely to be the most prolific generator of M&A activity over the next 12 months. Conversely, the financial services sector is forecast by 32% of respondents to be least prolific sector for dealmaking, reflecting stresses in the banking sector and broader market dislocation.

2

Almost two-thirds of respondents, 64%, identify North America as one of the most attractive destinations for M&A over the next 12 months, indicative of a flight to security on the part of dealmakers globally. At the other end of the spectrum, economically underperforming Japan (48%), inflation-laden Latin America (42%), and post-Brexit UK (40%) are broadly identified as the least attractive destinations for M&A.

3

In response to the challenging economic and credit environment, large subsets of respondents are shifting their M&A strategies to focus more on alternative investments (34%) and minority deals/joint ventures (32%). Divestments and restructuring-related deals are also expected to come to the fore (28%), with many companies likewise narrowing their focus on core sectors and geographies (30%).

4

With the recent banking crisis still fresh in everyone's minds, 72% of respondents expect financing conditions to worsen compared to 2022, including 38% who expect them to become much more challenging. In response, dealmakers are turning increasingly toward alternative financing sources, including private equity (64%) and non-bank lending (38%).

5

Almost all survey respondents, 96%, expect ESG scrutiny in deals to increase over the next three years, including 48% who expect it to increase significantly. Relatedly, 24% say environmental litigation creates the most concern with respect to potential disputes in a deal, up from just 2% who said the same in the previous edition of this research in early 2022.

6

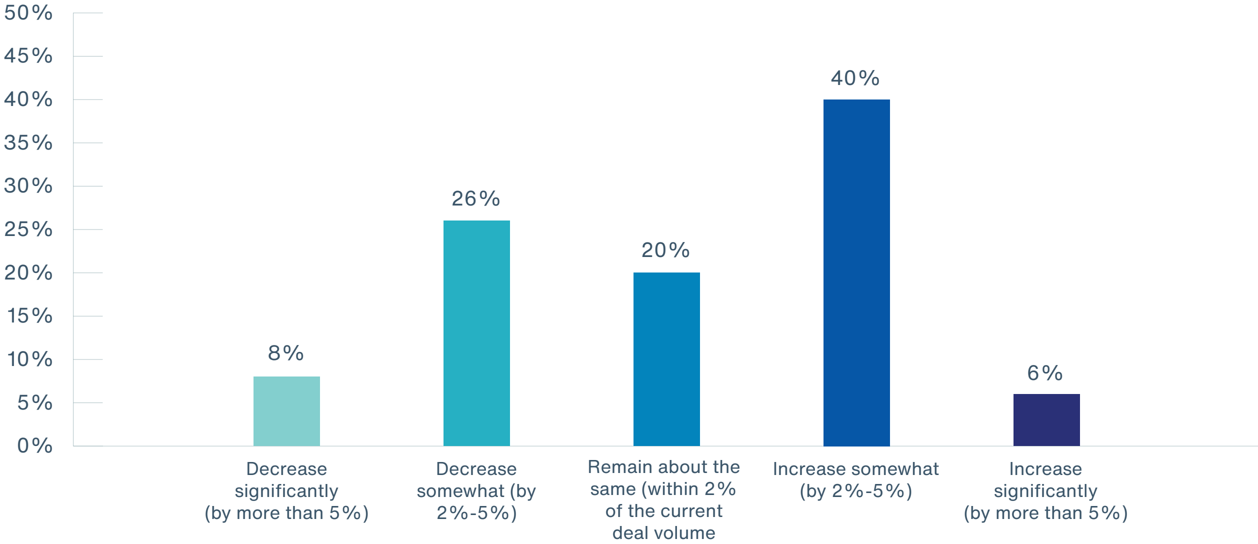
Just over half of respondents, 54%, currently employ credit risk technology, though the adoption and application of these technologies is not always smooth. More than half, 56%, cite difficulties in resourcing skilled workforces, and large subsets point to challenging procedural processes (48%) and poor standards of reporting (42%).

Part 1: M&A trends in the next 12 months

Even following a period of pronounced market anxiety, dealmakers remain upbeat about the health of the M&A arena. Almost half of respondents to our survey, 46%, expect the number of deals globally to increase somewhat or indeed increase significantly over the next 12 months compared to 2022. A further 20% expect figures for the year ahead to remain in line with current volumes.

Though less enthusiastic than respondents to our equivalent study in early 2022 – when 68% of respondents forecast an increase in M&A volumes – these findings are indicative of a deal-hungry market, even as executives navigate a difficult business environment.

1. What do you think will happen to the number of M&A deals globally over the next 12 months compared to 2022? (Select one)



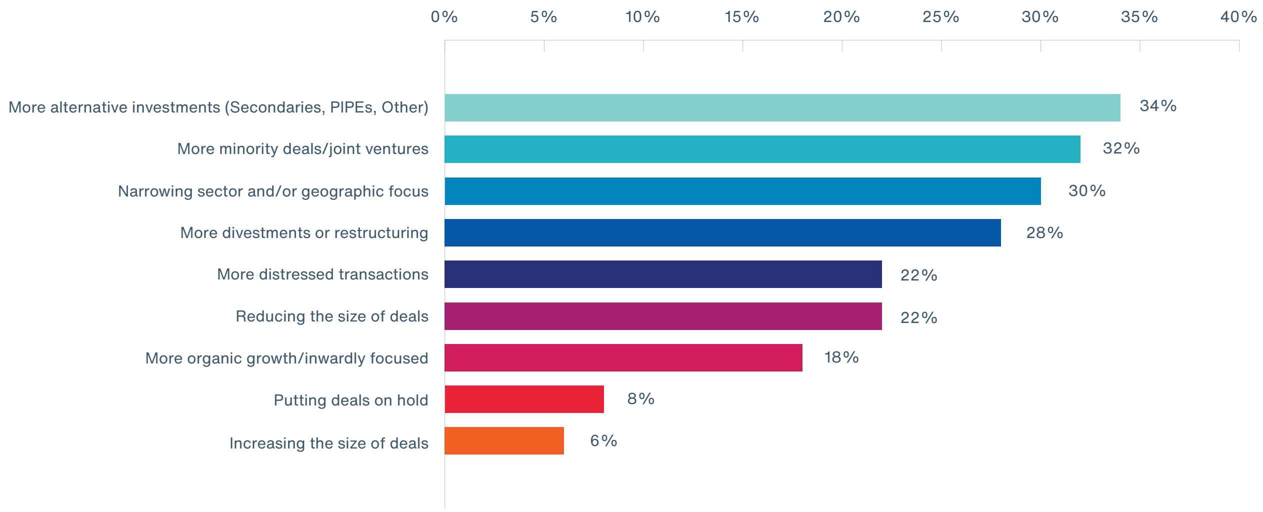
In response the challenging macroeconomic environment, geopolitical unrest, and uneven market performance, respondents to our survey this year are adjusting their strategies to capitalize on different deal structures. Around a third say they intend to incorporate more alternative investments (34%) and pursue more minority deals/joint ventures (32%).

This environment also opens opportunities to explore distressed business – 22% of respondents say distressed transactions are likely to become a more pronounced part of their strategy. Deals like this can present significant risk, but there are methods to mitigate such concerns. Adopting strong due diligence programs across key risk areas and a robust risk transfer strategy that leverages transaction insurance capital is vital.

Relatedly, 28% of respondents say they are focusing more on divestments and restructuring. Carve-outs have seen growth as companies prune non-core business lines and buyers look to strengthen their existing portfolio or pursue assets with growth potential. In these transactions, it is critical to take a holistic view of how cyber and people programs are managed on both the buy- and sell-side.

Secondary transactions are also on the rise as financial sponsors look to generate liquidity for their investors. Aon sees this as a long-term trend. These deals, however, present risks that may require capital to be escrowed, potentially eroding long-term returns. In response, it is important for financial sponsors to take a page from their traditional M&A playbooks and leverage insurance capital to realize a range of economic and deal benefits.

2. How is your M&A strategy adjusting this year, particularly with respect to a challenging credit and economic environment, coupled with an uneven market performance and geopolitical instability? (Select two)

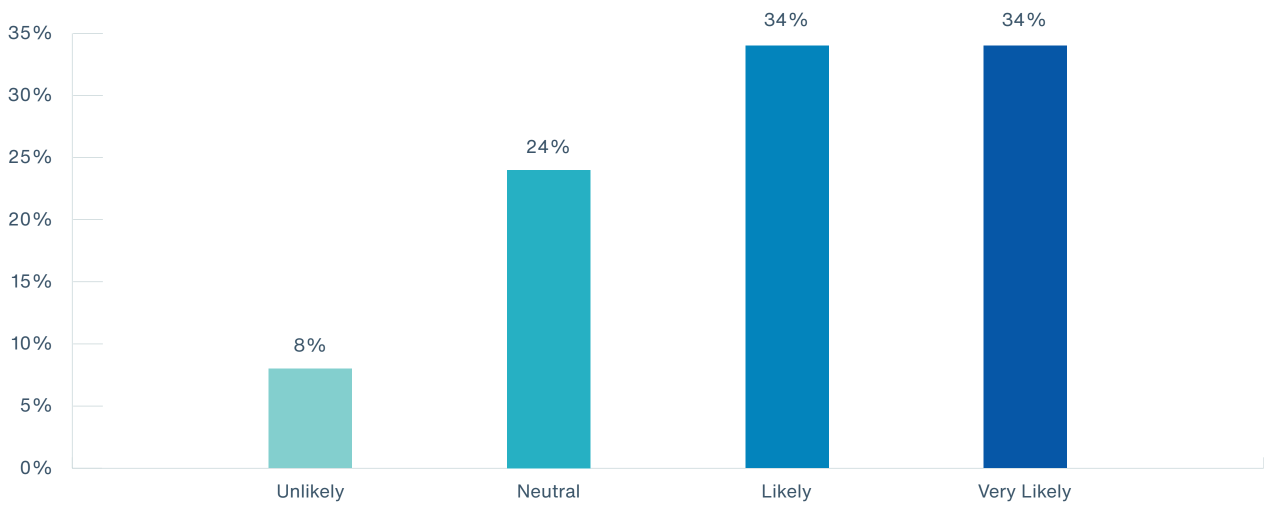


Given the broadly uncertain business environment, 68% of respondents say they are either likely or very likely to take a programmatic approach to M&A, pursuing many smaller deals rather than larger, one-off transactions. Correspondingly, only 6% say they are adjusting their M&A strategy by increasing the size of deals they undertake.

> **We might adopt this approach if we cannot find any large, one-off transactions to fulfill our deal objectives. Our decision-making will depend on the region in which we conduct the deal and the market stability," says a Netherlands-based partner of a private equity firm. The head of business development and M&A of a Swedish corporate adds, "In this fast-moving business environment, we cannot wait for larger one-off transactions that are suitable for our objectives. We have to be more proactive in recognizing the small opportunities that are available."**

Aon sees the same pattern toward small deals, alongside a more risk-averse approach. Insurers in the M&A space have been responding to this trend with an increased interest to cover small transactions where the economics were previously unattractive.

3. In an increasingly uncertain, fast-moving business environment, how likely are you to pursue many small deals in a programmatic approach as opposed to larger, one-off transactions? (Select one)



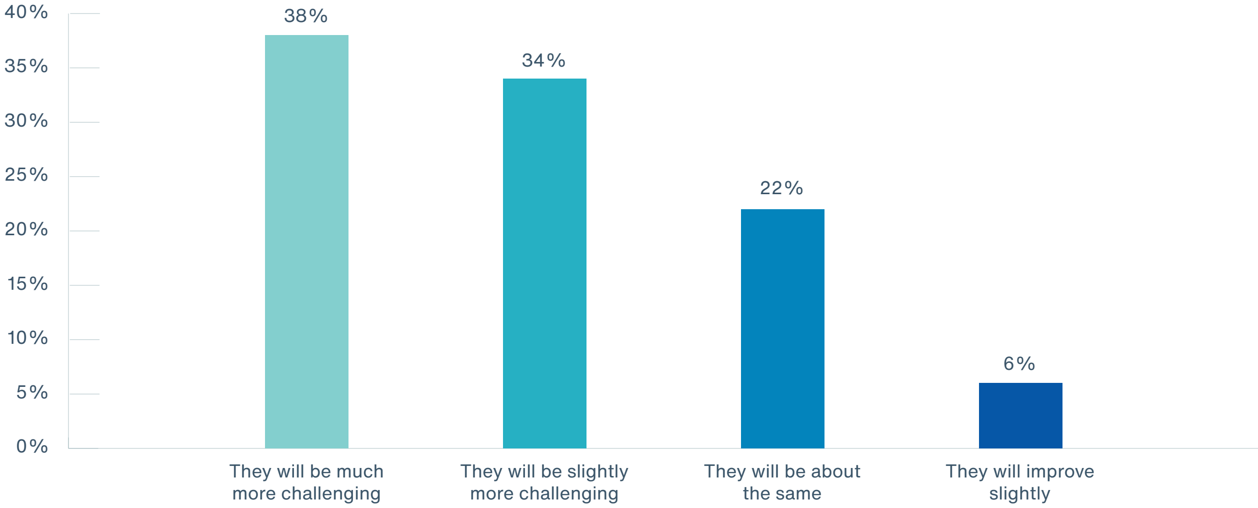
Financing prospects

A run of persistently high inflation led central banks to aggressively raise interest rates over the last 12 months, causing financing conditions to tighten and creating significant knock-on effects for key industries.

Almost three-quarters of respondents, 72%, expect financing conditions to worsen compared to 2022, including 38% who expect them to become much more challenging, particularly in light of recent stresses in the banking sector. These findings are marginally more pessimistic than those generated in the previous edition of this study from 1H 2022, when 70% said they expected financing conditions to become more difficult, including 30% who expected them to become much more challenging.

> **It will be a struggle availing financing for growth and for transformational deals," admits the managing director of an investment bank in China. "Financing for small deals will also take a while to be approved because of the increasing market risks."**

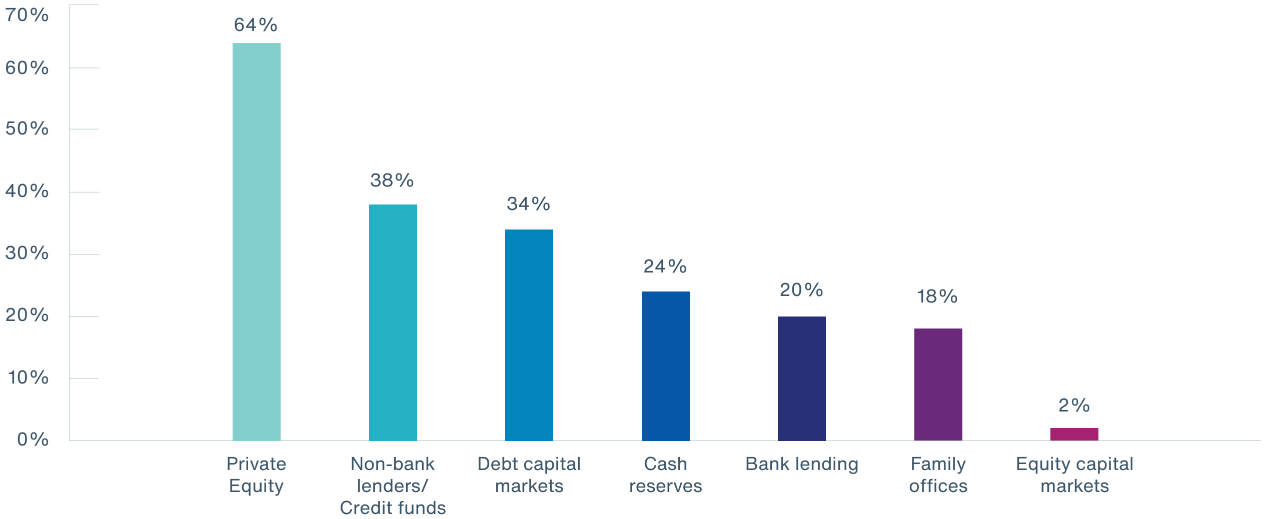
4. How do you expect financing conditions over the next 12 months to compare to conditions in 2022, particularly in response to the recent banking crisis? (Select one)



In response, dealmakers are deliberating even more closely where to source funding for deals. Most respondents, 64%, say private equity will become a primary source of financing over the next 12 months, followed at some distance by non-bank lending/credit funds (38%) and tapping debt capital markets (34%). Almost none, at just 2%, cite equity capital markets, down from the 12% who said they would tap these in our 1H 2022 study.

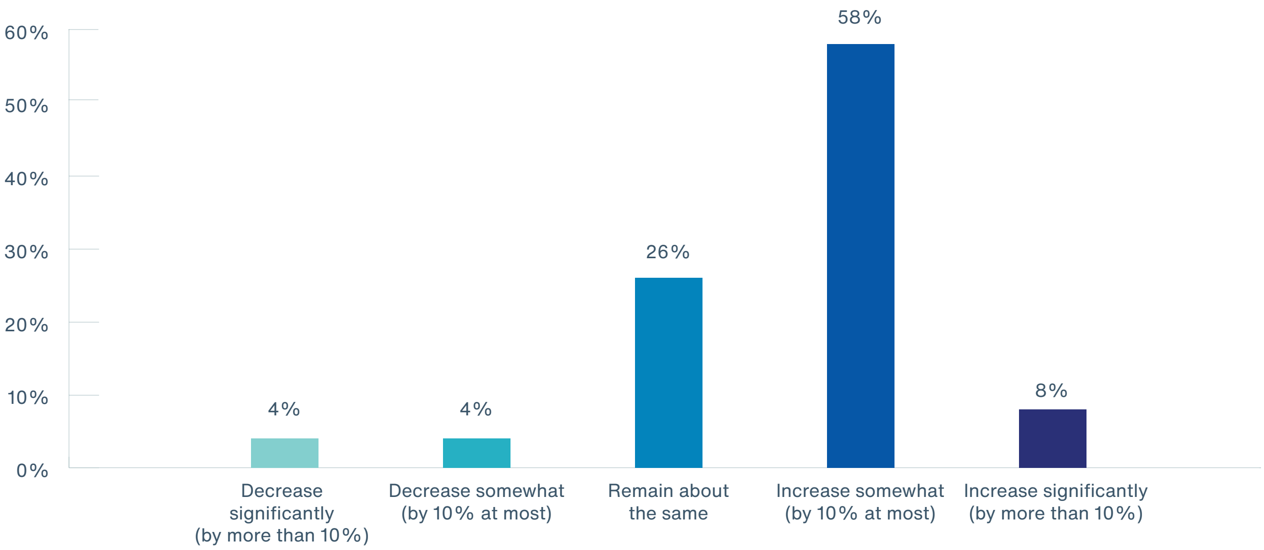
> **As the senior executive vice president of strategy of a French corporate puts it, "In many markets, there are already limited financing options. Since the economic threats have increased, these have become even more scarce. Investors have to think about alternative ways to raise funds. They might opt for sales of assets to raise funds for new growth opportunities."**

5. What do you believe will emerge as the primary sources of financing over the next 12 months? (Select top two)



While tighter financing conditions are undeniably a challenge that all dealmakers would rather see the end of, some sectors are in a position to capitalize on current circumstances. Around two-thirds of respondents, 66%, expect the current inflation and interest rate environment to lead to an increase in infrastructure secondary market deal volumes over the next 12 months.

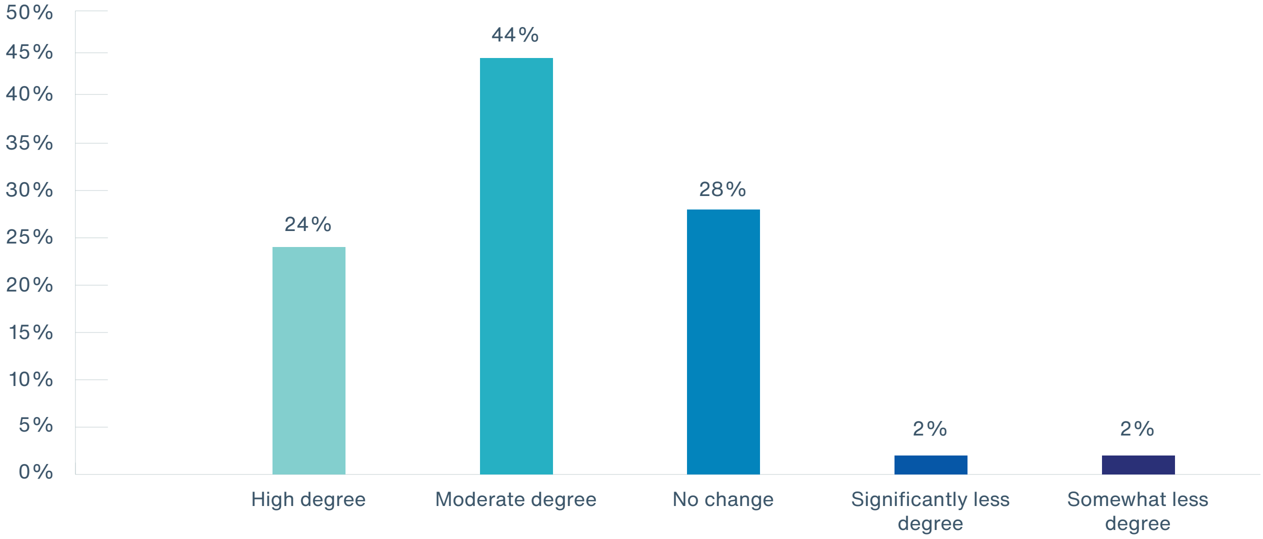
6. How will the current inflation and interest rate environment impact infrastructure secondary market deal volumes over the next 12 months compared to 2022? (Select one)



Infrastructure investment has been a pillar of US policy under the current administration, encapsulated in last year's IRA and the related 2021 Infrastructure Investment and Jobs Act. A large majority of respondents, 68%, expect the expanded tax incentives under the IRA to drive global investment in US infrastructure to a disproportionate degree compared to the rest of the world.

Investment in domestic energy production and sustainability in particular are crucial elements of the IRA. Aon's Tax Insurance practice has seen an uptick in renewable energy developers based in non-US jurisdictions making investments in renewable energy assets in the US. The inclusion in the IRA of the transferability of tax credits, as opposed to needing to structure a tax equity investment in order for developers to monetize the credits, is expected to broaden the pool of companies that provide capital seeking a return in tax credits beyond the typical bulge bracket banks. As a result, we anticipate some of the future investment in the US to include new technologies that may qualify for tax credits.

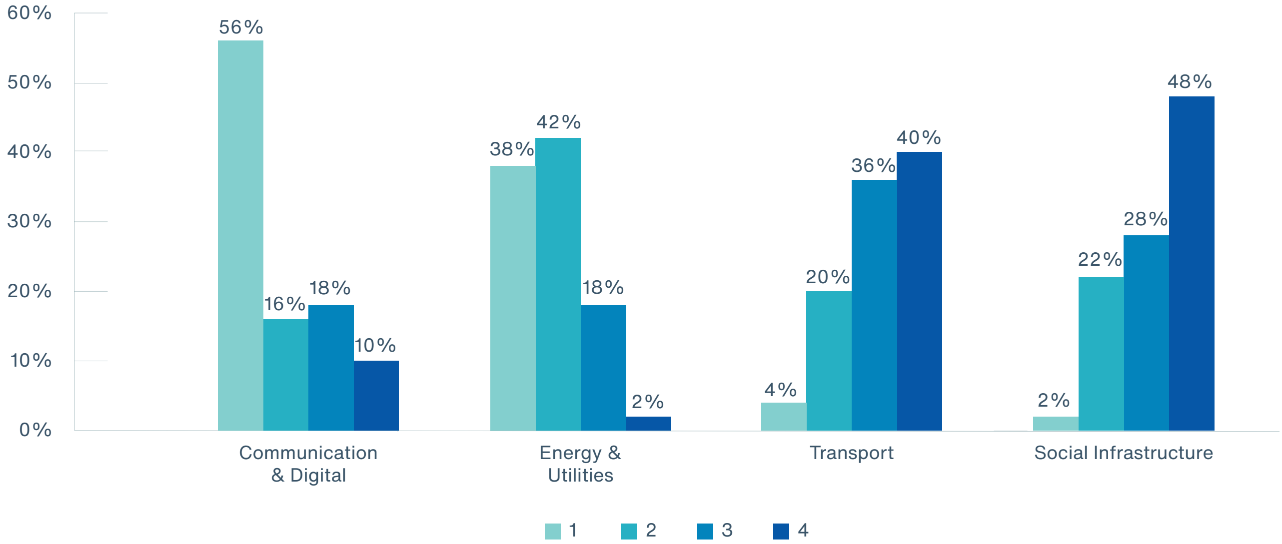
7. To what degree do you expect the expanded tax incentives under the Inflation Reduction Act to drive global investment in US infrastructure disproportionately to the rest of the world? (Select one)



Respondents to our survey are especially bullish on dealmaking prospects in the communication & digital space. More than half, 56%, believe this subsector of the broader infrastructure industry will attract the greatest focus for secondary market transactions in 2023. This reflects a continuation of the heavy and sustained investment into communication infrastructure seen since the early stages of the pandemic.

The next most prevalent subsector is expected to be energy & utilities, followed by transport – customer demand for related assets having recovered to or nearing pre-pandemic levels – and finally social infrastructure.

8. Which of the following subsectors do you anticipate having the greatest focus for secondary market deals in 2023? (Rank from 1 to 4, where 1 is the subsector attracting the most focus)



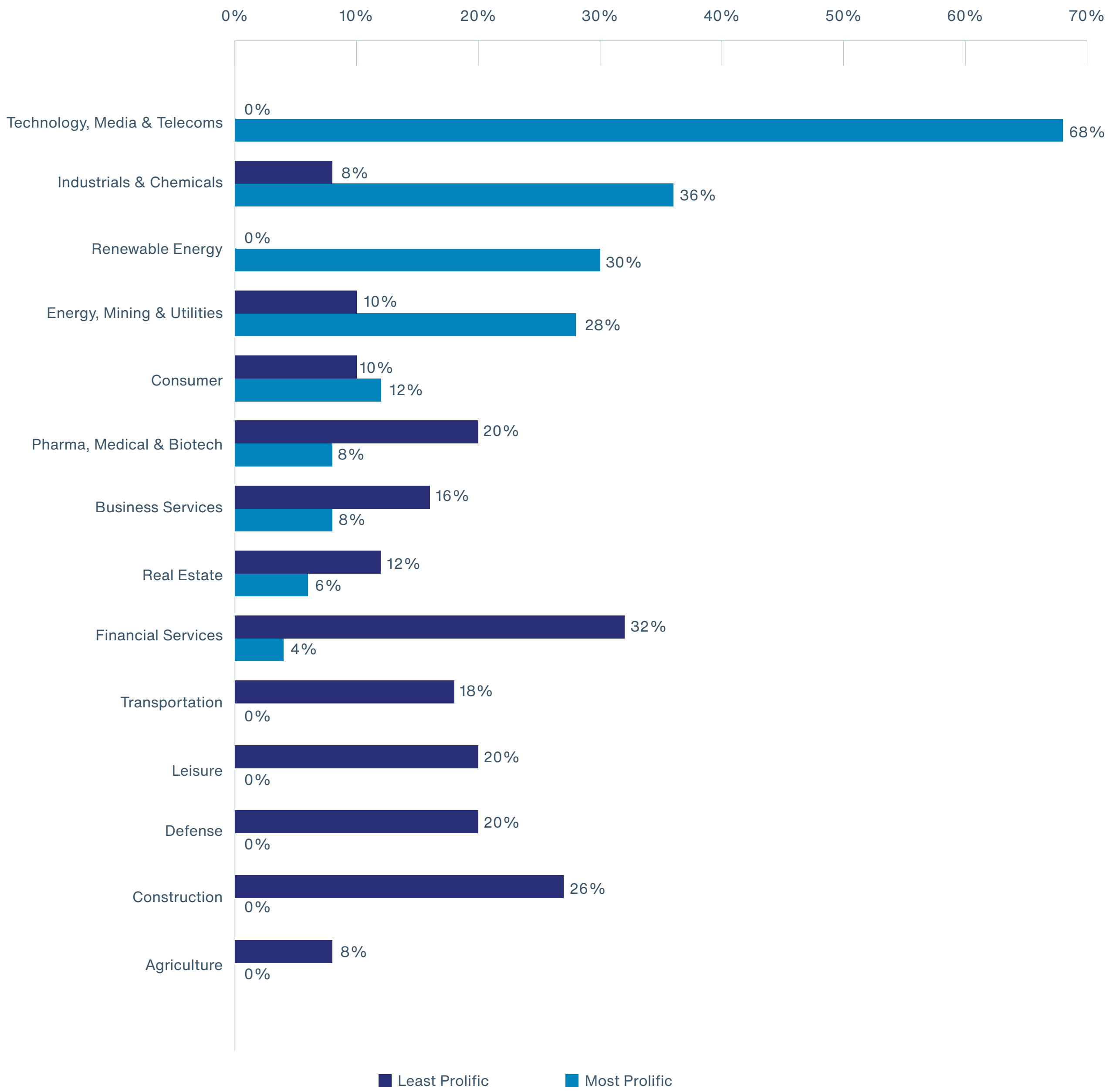
Identifying opportunities: Sectors

The TMT sector has recorded remarkable growth over the last several years, reflecting widespread technological innovation and its increasing intersection with other industries pursuing digital transformation. This trend is very unlikely to diffuse in the term.

More than two-thirds of respondents – 68%, putting it far ahead of the next-most-popular answer – expect TMT to be one of the most prolific deal generators over the next 12 months, in line with the 70% who said the same in our 1H 2022 study.

Conversely, the least prolific sectors this year are expected to be financial services, cited by 32% of respondents, and construction, identified by 26%. Respondents in our 1H 2022 report were just as downbeat in their forecasts for the construction industry, but financial services has suffered a notable drop-off. Last year it was identified as likely to be the third-most-productive sector for M&A, but mounting inflation and market volatility are deterring higher-level dealmaking.

9. Which of the following sectors do you believe will be the most/least prolific in terms of M&A activity over the next 12 months? (Select two for 'most prolific' and two for 'least prolific')

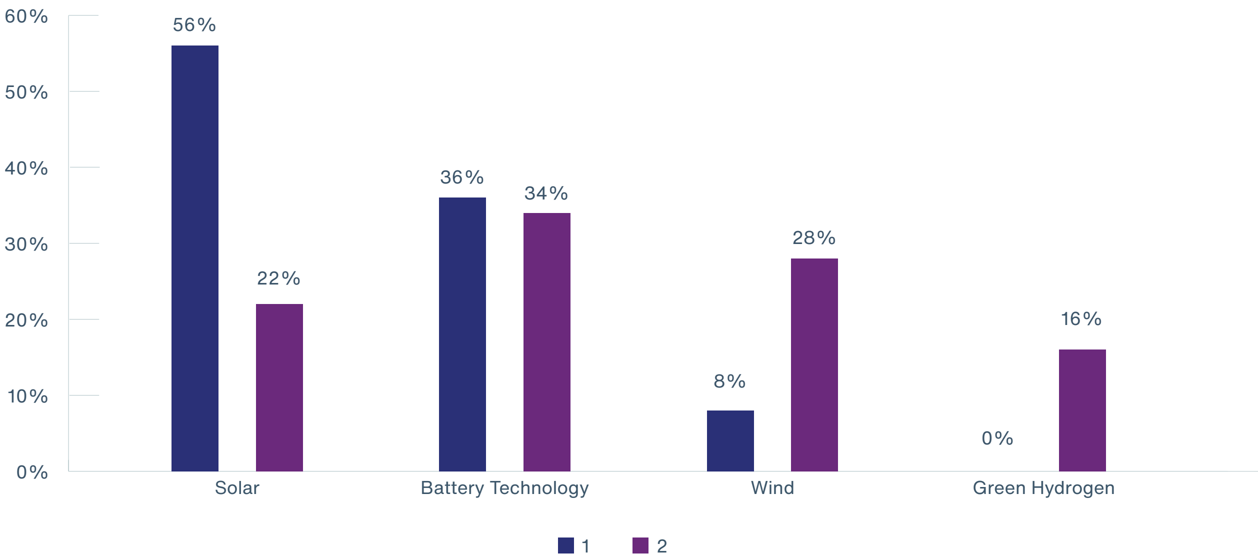


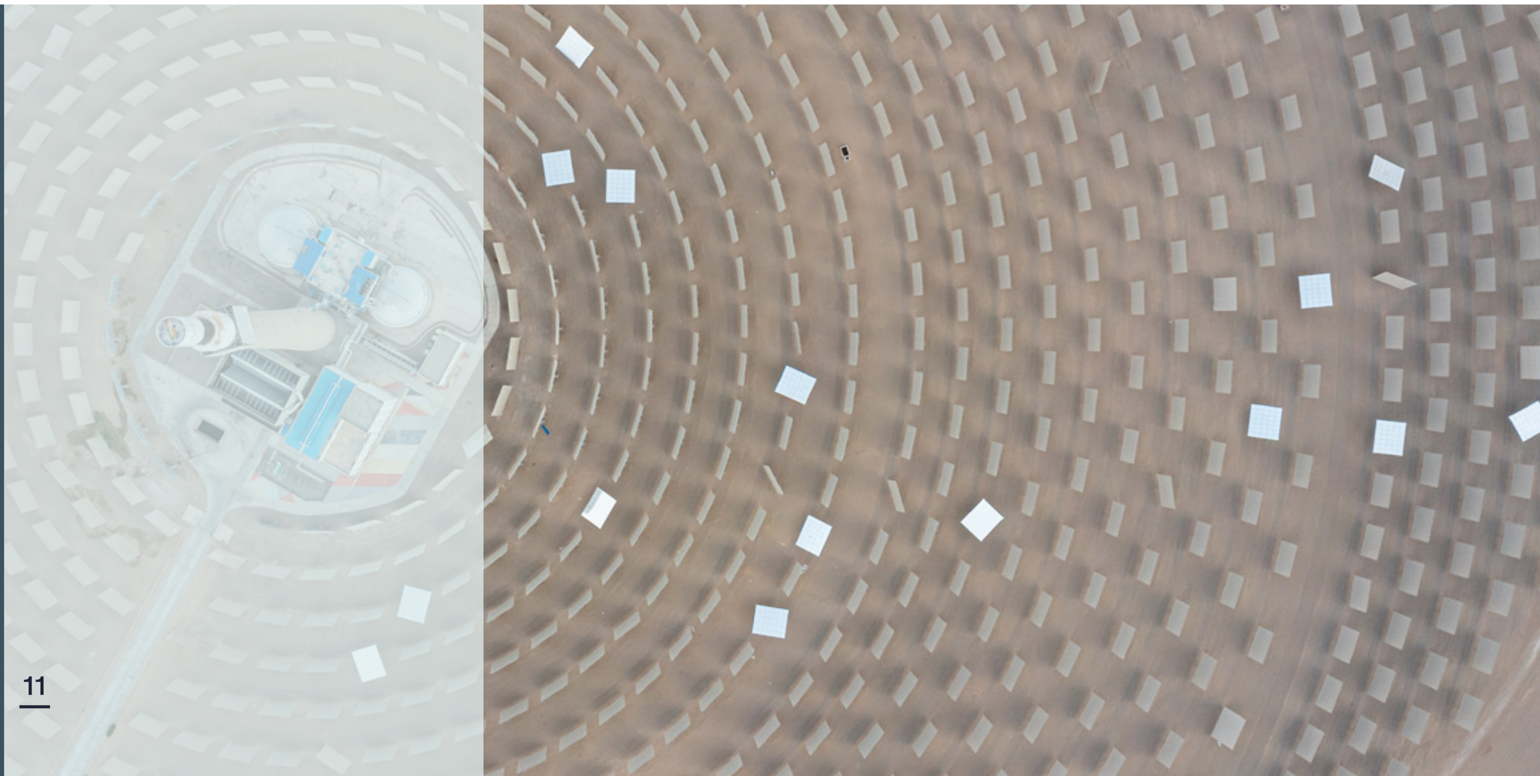
After TMT, industrials & chemicals and renewable energy are expected to be the next-most-prolific sectors, accruing 36% and 30% of votes, respectively. The former's performance represents a notable increase from last year, when only 8% of respondents said industrials & chemicals would generate notably high transaction volumes over the proceeding 12 months.

Regarding the renewables space specifically, most respondents, 56%, believe solar technologies, perhaps the most established subsector, will present the most attractive opportunities for investment over the next 12 months. The next-most-popular response is battery technologies, identified by 36% of respondents as the most attractive subsector, reflecting rapid innovation in the space and strong government support.

Green hydrogen technologies accrue the fewest votes from our respondents at this time. While still in its early stages compared to better-established solar and wind technologies, there has been a significant uptick in focus on hydrogen over the last 12 months from both strategic and financial investors. This is an asset class that many more believe will grow exponentially in the years ahead.

10. Which of the following renewable energy technologies do you believe will be the most attractive for investment over the next 12 months? (Select two and rank 1-2, where 1 is the most attractive)



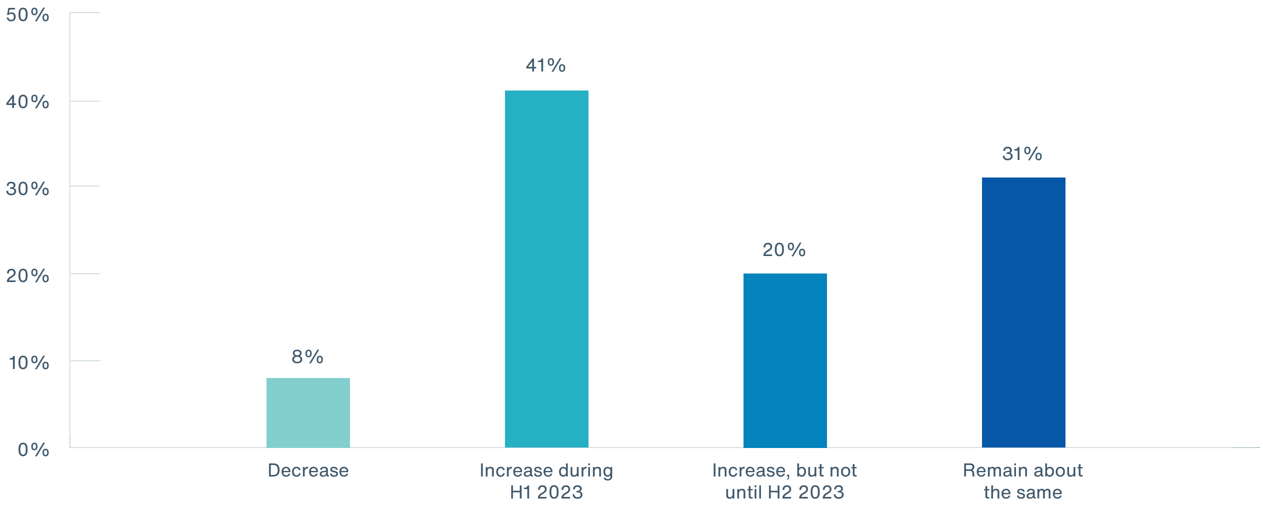


Real estate M&A

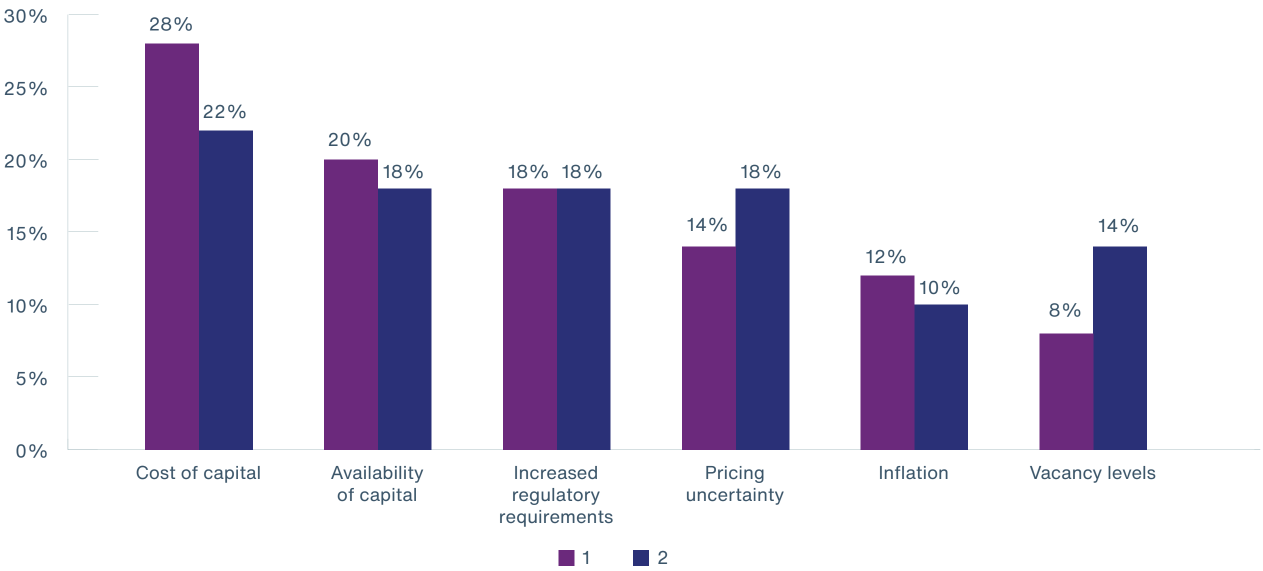
Respondents are bullish on the state of M&A in the real estate sector. The bulk of survey participants, 41%, expect real estate M&A to increase during 1H 2023 compared to 2022, while a further 20% expect the increase to come in the latter half of the year. Meanwhile only 8% are forecasting a year-on-year decrease in activity.

In the first quarter of 2023, some Aon clients paused transactions, reflecting elevated property market valuations and the high cost of borrowing. In fact, the cost of capital and availability thereof were identified by 28% and 22% of respondents, respectively, as the primary factors influencing their current real estate M&A strategies.

11. How do you expect real estate M&A activity to change in 2023 compared to 2022? (Select one)



12. What are the primary factors currently influencing your real estate M&A strategy? (Select top two and rank 1-2, where 1 is the most important factor)



Moving into the second quarter and beyond, clients will be looking for optimized pricing before transactions are likely to increase significantly. However, investors will need to deploy capital over the course of 2023, which will prop up transaction activity before a more noticeable increase materializes later in the year and carries over into 2024.

Aon sees especially positive asset trends in the warehousing, student accommodation, and build-to-rent residential subsectors. As touched on earlier in this report, infrastructure assets, including offshore and onshore energy, and particularly wind farms, are also likely to be a key driver of real estate M&A.

Continued demand for logistics assets is also visible, although there has been some regression as occupiers contend with the rising cost of living. Footfall for high-street retail has recovered to pre-pandemic levels, although challenges remain around market valuations, which continue to come under pressure.

There is a strong focus, too, on repurposing assets to ensure they respond to changing requirements as consumption habits evolve. Relatedly, transition risk remains a priority for the real estate sector as clients look to alleviate their carbon output and focus on energy efficiency by investing in environmentally friendly enhancements and green technology.

Investment bankers' viewpoint

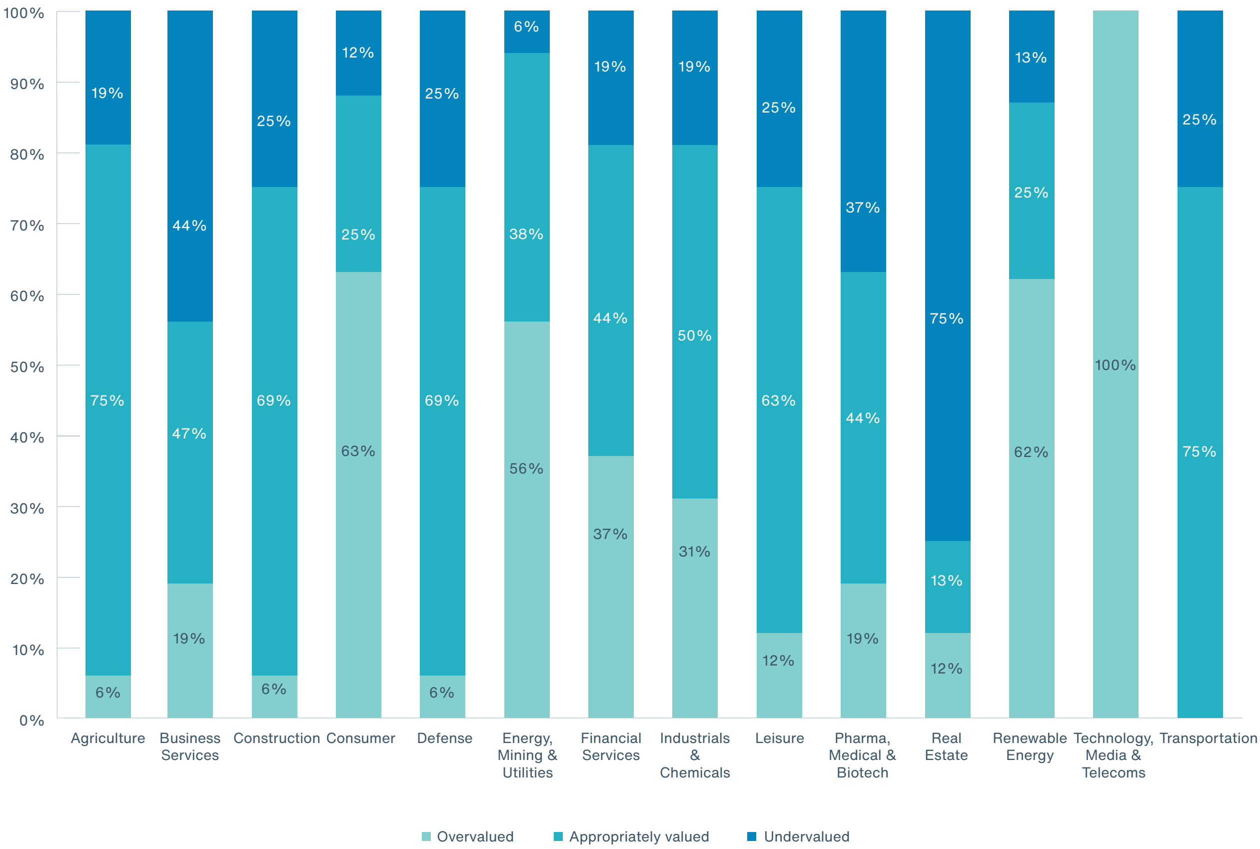
Investment bankers are in a unique position to comment on the health of the M&A market, particularly with respect to buyer vs. seller expectations regarding asset valuations.

According to our respondents who represent investment banks, sellers and buyers have been furthest apart with respect to assessing value during negotiations over deals in the TMT sector. All investment bankers surveyed believe TMT assets are overvalued, up from the 75% who said the same in our 1H 2022 study. No other sector generates a consensus view to that degree, though more than half of our respondents do say that assets in consumer (63%), renewables (62%), and energy, mining & utilities (56%) are also overvalued.

Conversely, the vast majority of investment bankers surveyed, 75%, believe deals in the real estate sector are currently undervalued. There is no other sector in which more than half of our respondents believe assets are undervalued, though business services, at 44%, comes closest. In other large sectors, such as industrials & chemicals (50%) and pharma, medical & biotech (44%), among others, assets are considered by the bulk of investment bankers to be appropriately valued.

Aon notes that the use of insurance capital can bridge the valuation divide and can encourage sellers to accept more modest value and exit their deal with more cash in their pocket.

13. In your experience, how far apart have sellers and buyers been in assessing value with respect to deal negotiations in each of the following sectors? (Select one for each sector)



Identifying opportunities: Regions

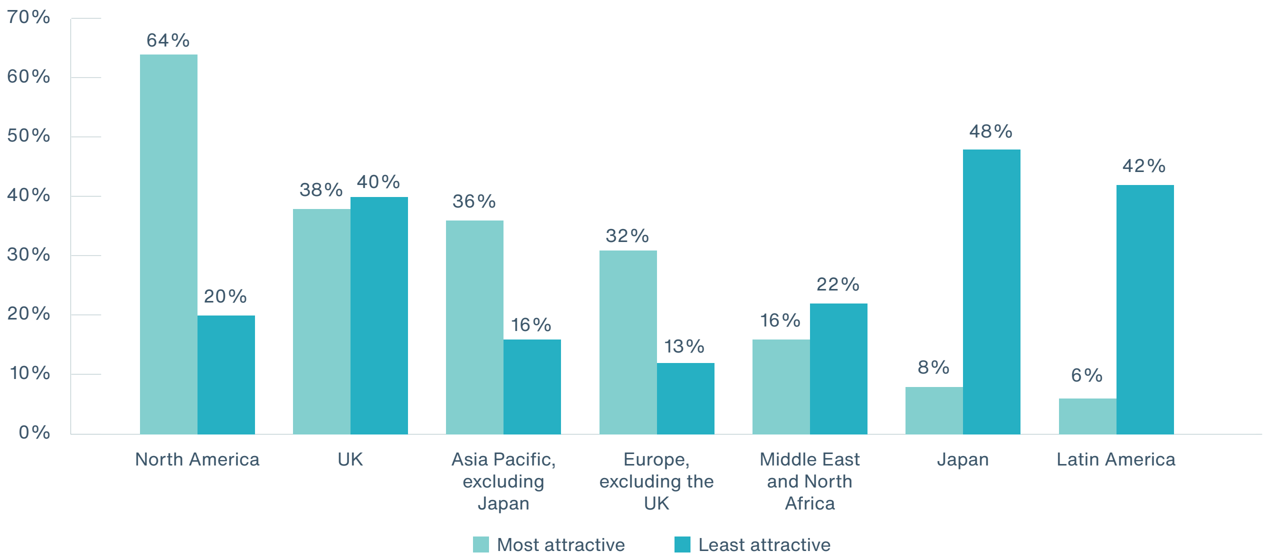
Regarding where in the world our respondents feel the most attractive dealmaking opportunities are to be found over the next 12 months, the bulk of survey participants are quick to cite North America, which overtakes Asia Pacific (excluding Japan), which took the top spot in our 1H 2022 survey.

Nearly two-thirds, 64%, identify North America as one of the two most attractive regions for M&A, far ahead of second-place UK, with 38% in terms of positive vote share. In fact, a slightly higher proportion of respondents, at 40%, believe the UK will be one of the two least attractive regions for M&A over the next 12 months, indicative of the country's weak growth prospects, political uncertainty, and ongoing post-Brexit economic dislocation.

In comparison to the UK, our respondent group is less ambiguous in its partiality for Asia Pacific (excluding Japan) and Europe (excluding the UK), which 36% and 32% of survey participants, respectively, identify as among the most attractive regions for M&A in the near term. Only 16% describe Asia Pacific (excluding Japan) as an unattractive destination, and just 12% say the same of Europe (excluding the UK).

Japan itself, however, is not viewed positively. Almost half of our respondents, 48%, the largest such share, believe it will be one of the two least attractive destinations for M&A over the next 12 months. The country has been defined for decades by stagnant growth, lackluster returns, and corporate underperformance. Although policy-makers in Japan are taking steps to embed higher governance standards and spur business development, reputational change will come in stages, not overnight.

14. Which of the following regions do you believe will be the most attractive and least attractive for M&A over the next 12 months? (Select two for 'most attractive' and two for 'least attractive')



Part 2: Risks and regulations

Rarely have prospective dealmakers had to navigate quite so many complex and disparate threats as they do today. From rapid technological innovation and changing workplace habits to the climate crisis and geopolitical upheaval, the factors at hand risk affecting the length and breadth of practically all industries.

Asked to identify the top three risks that their organizations face over the next 12 months, the largest share of respondents, 72%, cite environment, social, and governance (ESG) factors and climate change.

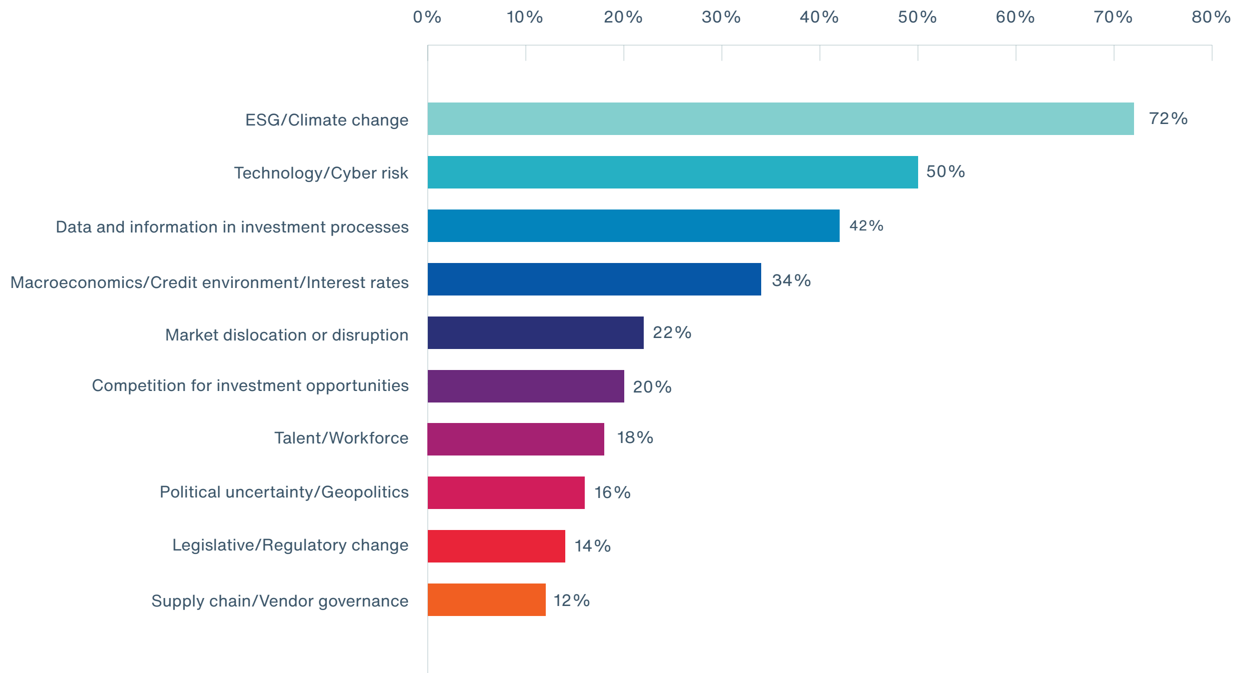
> **ESG is an important part of business activities today. However, the quality of ESG information is not up to the desired standard each time. This increases the risks of investing in sectors that are known to be carbon intensive," says the managing director of an investment bank in Canada.**

In a distant second and third place are a pair of technology-related risks, reflecting the already-rapid digitalization of business functions that was accelerated during the pandemic. Half of respondents cite technology/cyber risk as a main point of concern, and 42% say the same of risks concerning data and information in investment processes.

> **The managing director of an investment bank in Germany warns that "technology risks have increased a lot over the last few years. Some companies are using legacy technologies, and others have not updated their technology infrastructure. There could be unknown cyber risks here."**

In comparison, political uncertainty/geopolitics (16%), which is currently garnering a great deal of media attention, and legislative/regulatory change (14%), a thorn in dealmakers' side, are hardly considered to be major risks at all in 2023. Evidently, respondents feel that other hazards, over which they have more control, must be prioritized.

15. What are the most significant risks that your organization faces over the next 12 months? (Select top three)



ESG standards

In today's rapidly evolving business landscape, the integration of ESG factors has emerged as a critical consideration in making informed and responsible business decisions. It is not just a responsible choice, but a strategic imperative – considering and embedding ESG factors is no longer considered optional. It is therefore unsurprising that this sentiment is echoed by our survey respondents, most of whom expect ESG/climate change to be the most significant risk facing their organizations in the next 12 months.

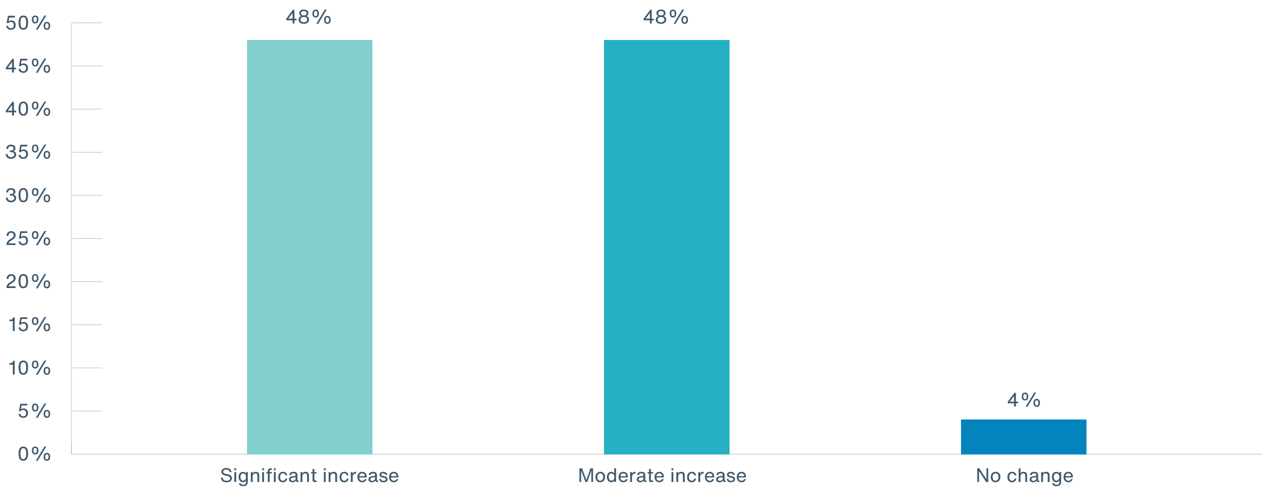
While this response from dealmakers focused on ESG-related risks, it is equally important to note that by incorporating ESG into their decision-making processes, organizations can unlock opportunities for growth, innovation, and enhanced stakeholder value. From attracting conscious investors and consumers to fostering employee engagement and securing regulatory compliance, embracing ESG principles has become integral for forward-thinking businesses.

In a transaction context, dealmakers must navigate sterner expectations from regulators, who are demanding greater transparency regarding how ESG factors are considered in the investment process. Investors, too, are raising the bar and demanding disclosure of more granular ESG information than ever before.

> **"The lack of transparency in ESG reporting and disclosures will increase ESG scrutiny during deals. Buyers will always be somewhat skeptical about the ESG standards sellers portray, and they would prefer to check all information thoroughly. This skepticism has increased due to excessive greenwashing," says a Canada-based managing director of an investment bank.**

As a result, dealmakers today are much more focused on ESG issues during the investment lifecycle, and particularly at the due diligence stage. Almost all survey respondents, 96%, expect ESG scrutiny in deals to increase over the next three years, including 48% who expect it to increase significantly. This affirms the data illustrated in our 1H 2022 survey, when 90% of respondents said they expected to ESG scrutiny to increase. Moreover, all but 2% of this year's survey group report that they have turned down one or more deals due to ESG concerns in the last 12 months.

16. How do you expect ESG scrutiny to change in deals over the next three years? (Select one)



Apart from regulatory and investor pressures, growing public mindfulness about sustainability, the reputational risks associated with ESG missteps, and the proven competitive advantage offered by strong ESG performance are further cementing the role of ESG due diligence as a non-negotiable part of the investment process moving forward.

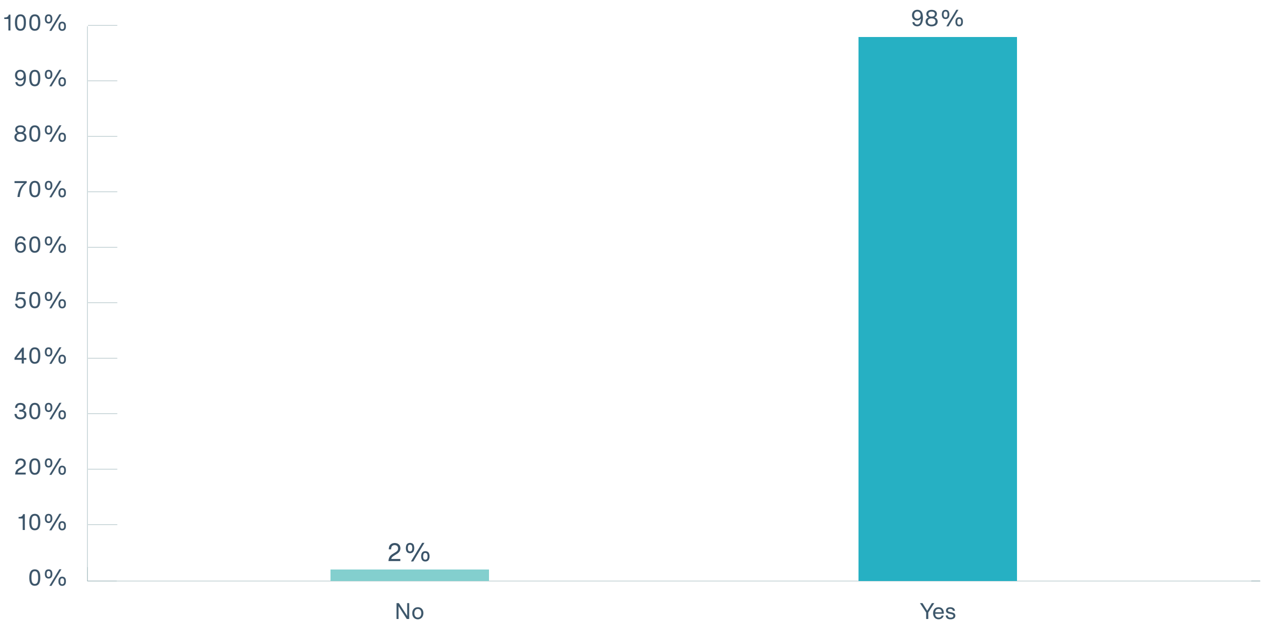
Organizations that fail to meet these benchmarks risk missing out on major opportunities.

> **As the managing director of a US investment bank explains, "Many companies do not have mature ESG strategies. This can affect the ESG performance over time. There could be limited financing available companies who do not emphasize good ESG practices."**

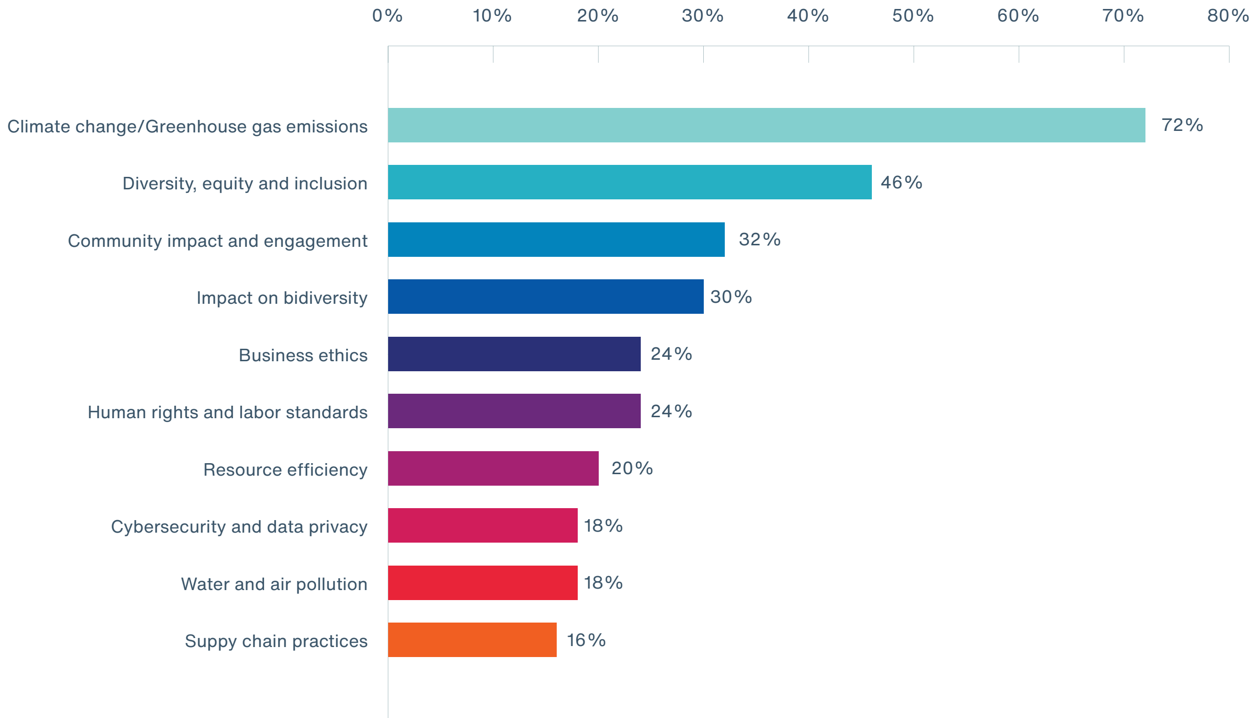
In terms of specific ESG factors being particularly important to our respondents, climate change/greenhouse gas emissions stand out, with 72% citing it as one of their three key ESG considerations during investment decision-making. Understanding a target company's exposure and, critically, its readiness to respond to both physical and transition climate risk is essential. This is followed at some distance by diversity, equity and inclusion (46%), community impact and engagement (32%), and biodiversity (30%).

What is also interesting about our survey findings is that none of the ESG factors were discounted by the respondents or received a dismissively low score. Yet their relative importance and the extent to which they may have a material financial impact on the company or transaction will depend in large part on the sector in which it operates. There is no one-size-fits-all approach to ESG due diligence. It must be comprehensive to cover all bases, yet set the appropriate focus.

17. Has your company turned down one or more deals due to ESG concerns over the last 12 months? (Select one)



18. Which of the following ESG considerations are key to your organization during investment decision-making? (Select top three)



Credit risk technology

The outlook for the global economy for 2023 is still cautious, with inflation, while down from the peaks recorded last year, remaining a prime concern in most developed economies.

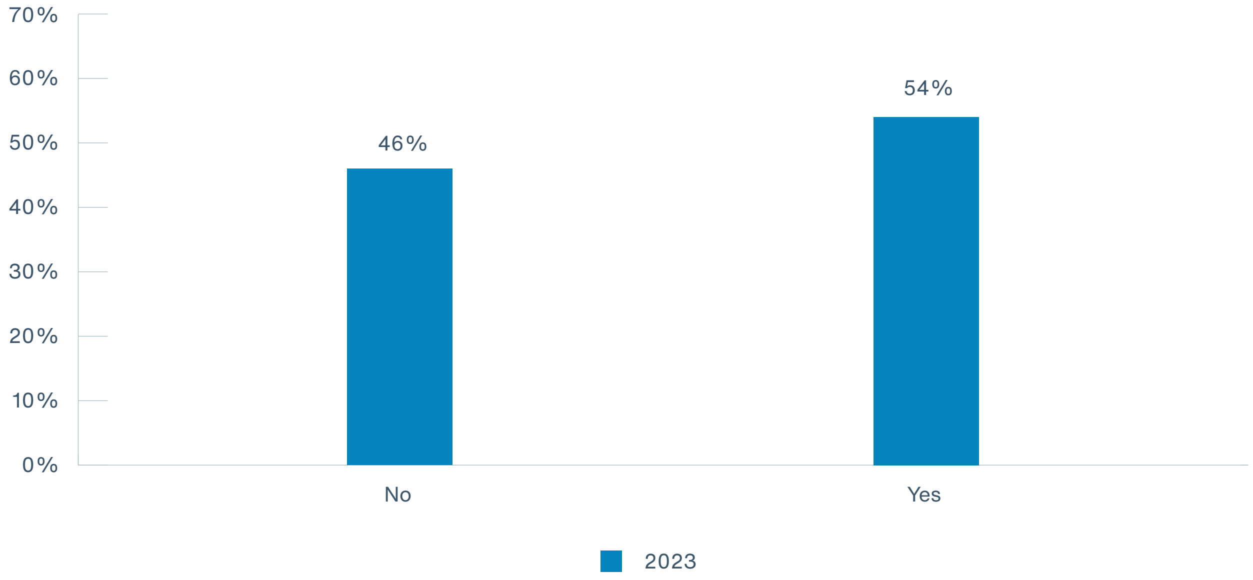
There were signs toward the end of 2022 of the exposure growth trend beginning to slow down as insurers prepare for a return to more normal underwriting conditions, reflecting uncertainty in the economic outlook and associated headwinds.

At the same time, the market at large continues to innovate through new specialist offerings, as well as the addition of new players providing complementary capacity for more complex and larger risk exposures. Company balance sheets are beginning to feel the effects of these pressures, and this is echoed in insurers' approach to risk.

In this environment, it important for businesses to adopt more flexible and efficient financing options and develop a strong credit strategy to create economically attractive options for lenders. This can be achieved by capitalizing on credit solutions tools such as trade credit insurance, political risk insurance, and surety services.

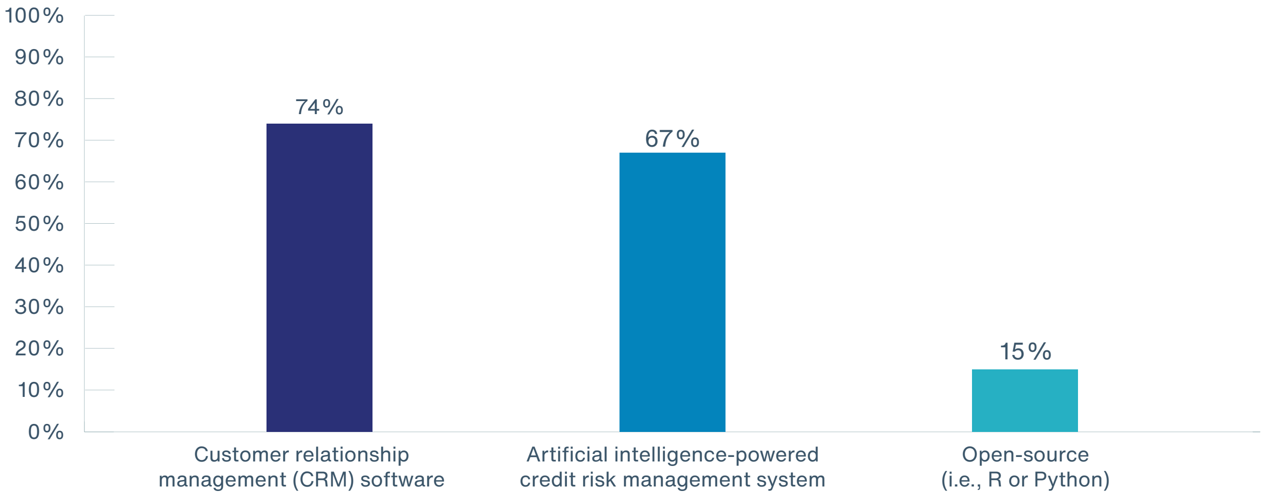
Our survey results show that global limit approval rates at the end of 2022 were down 400 basis points from 2021 and down 600 basis points from pre-pandemic levels. To address credit risk, 54% of dealmakers say they currently employ credit risk technology, up from our 1H 2022 study when fewer than half of respondents, 44%, reported the same.

19a. Do you currently have a credit risk technology in place? (Select one)



Of those who have adopted credit risk technology, almost three-quarters say they utilize customer relationship management software, and two-thirds employ credit risk management systems that are powered by artificial intelligence. Only a small minority, at 15%, say they make use of open-source technologies such as R or Python. The majority, evidently, are content with SAS credit risk modeling, which has been the industry's preferred software for decades.

19b. If 'Yes', what tools are you currently using to address credit risk? (Select all that apply)

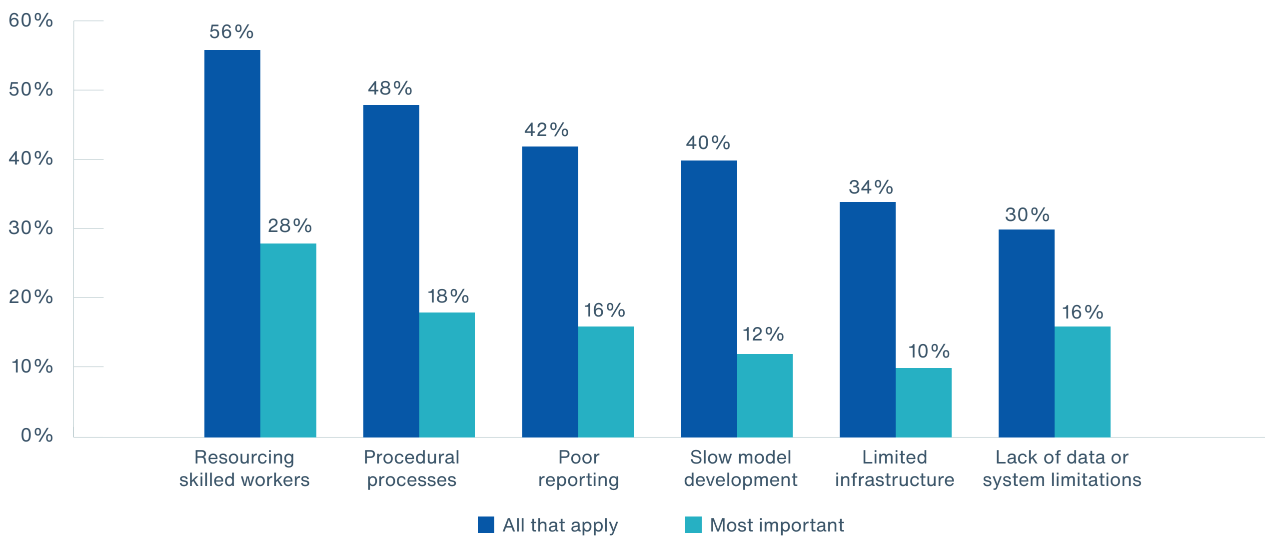


With that being said, many dealmakers worry that there is still significant work to be done to get the best out of technologies that address credit risk, whichever type they choose to employ.

Skills shortages can weigh heavily on organizations, with more than half of our survey respondents, 56%, identifying resourcing skilled workforces as a major obstacle. More than a quarter, 28%, by far the largest such share, cite this as the single most important challenge they face in addressing credit risk using technology. In our 1H 2022 study, resourcing skilled workforces was only the third greatest challenge referenced by respondents, underlining increased competition for talent over the last 12 months and the increasing complexity of the credit risk space.

Navigating procedural processes, cited by 48% of respondents overall and accruing 18% of most-important votes, and poor reporting, at 42% and 16%, are also identified as key challenges. Moreover, although only 30% of all respondents overall cite a lack of data or system limitations, 16% say it is the most important challenge they face. As in other industries, the increasing volume and complexity of data is an issue that dealmakers must quickly get on top of. Slow-footed organizations risk losing their competitive edge to rivals with more advanced data and analytics systems.

20. What are your greatest challenges in addressing credit risk using technology? (Select all that apply)

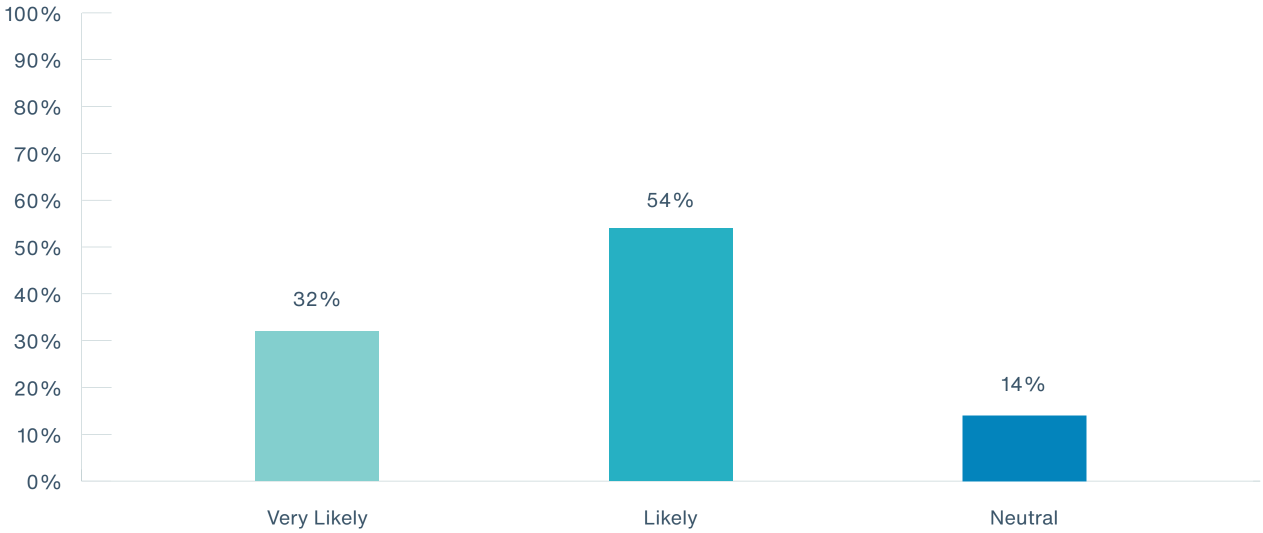


Cybersecurity

Aon continues to see a high correlation between M&A activity and cyber-attacks. One theory to explain this is that target companies and newly acquired entities are increasingly being brought to hackers' attention through M&A press releases and other media exposure, while previously transactions were more likely to be undertaken and announced with less fanfare and could fly relatively 'under the radar'. Add to this cybercriminals' expectations that the investment firm or corporate acquirer will have the necessary funds to pay a ransom, and they are perceived by malicious actors to be attractive targets.

In this changed threat landscape, many dealmakers often represent organizations that have themselves been targeted by hackers and have personal experience of the ensuing financial and operational impacts of cyber-attacks. Appreciating the potentially massive risk involved in acquiring a company with subpar defenses, the vast majority of respondents to our survey, 86%, say they are likely to abandon a deal if they uncover a material cybersecurity risk at the target company, including 32% who say they are very likely to walk away from a transaction.

21. How likely are you to walk away from a deal if a material cybersecurity risk has been discovered at the target company? (Select one)



The C-suite and investment committees are also prioritizing cybersecurity investment as a means to both create and protect value. Buyers are increasingly looking to conduct cybersecurity due diligence to establish whether a company has neglected to spend adequately and effectively on its defenses. On average, our survey respondents say they perform a dedicated, stand-alone cybersecurity due diligence review in 80% of the deals they undertake.

Rising technology dependency, both in the office and outside it, over the last few years makes dedicated reviews practically essential in all but the smallest of transactions.

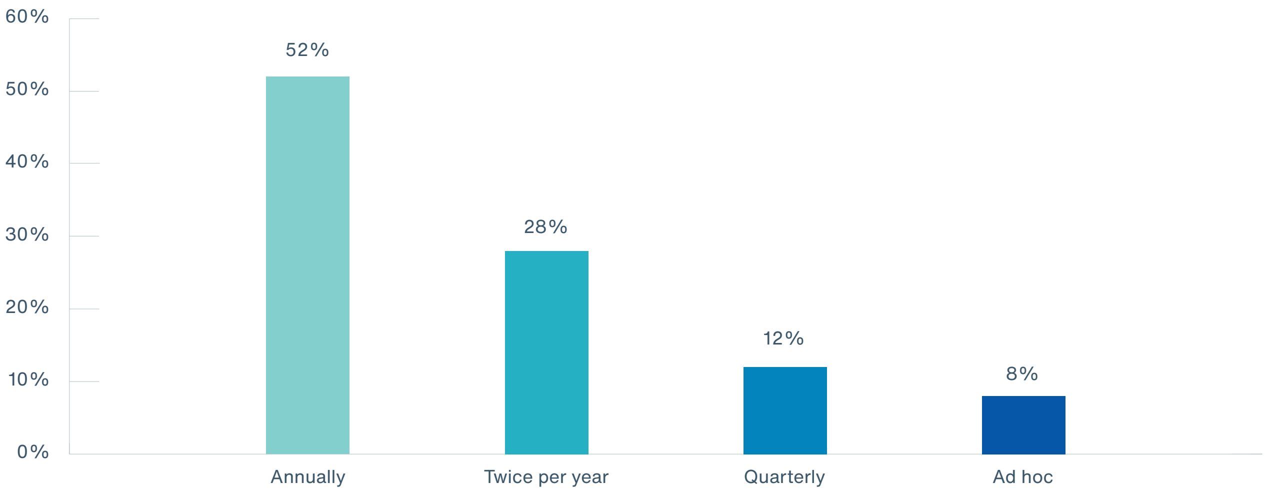
> **As the head of private equity of a firm based in the United Arab Emirates explains, "There are various locations from which company data is accessed. After the pandemic, remote working increased, and employees are using unsecured networks to access data. We need to conduct standalone tests to identify all risk factors."**

Bad actors can exploit the smallest gaps in a company's defenses, and often it is human error that opens those gaps. "To some extent, companies are unaware of whether their employees are following the prescribed cybersecurity practices. Even though there are provisions to make employees aware, testing their knowledge is not always done. These challenges are known to us only when we perform a dedicated review during all deals," says the managing director of an investment bank in Australia.

If the target appears to have come up short in terms of its cyber defenses and procedures, this will require the acquirer to increase investment post-close to bring them up to a baseline level of security, assuming they are sufficiently happy to pursue the deal at all.

But comprehensive cyber diligence applies not only to potential targets, but also to existing investments and portfolio companies. Among our survey respondents, most, 52%, say that annual cybersecurity assessments of their existing investments are sufficient for their organization. Over a quarter, 28%, say these review are conducted twice per year, while 12% advocate quarterly check-ups.

22. How frequently do you assess cybersecurity in your existing investments? (Select one)

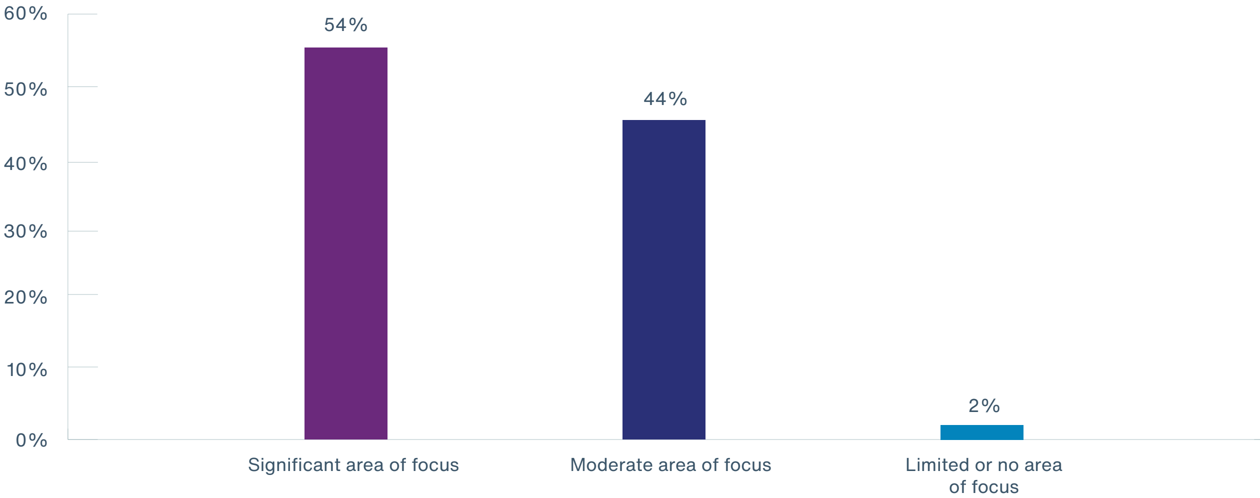


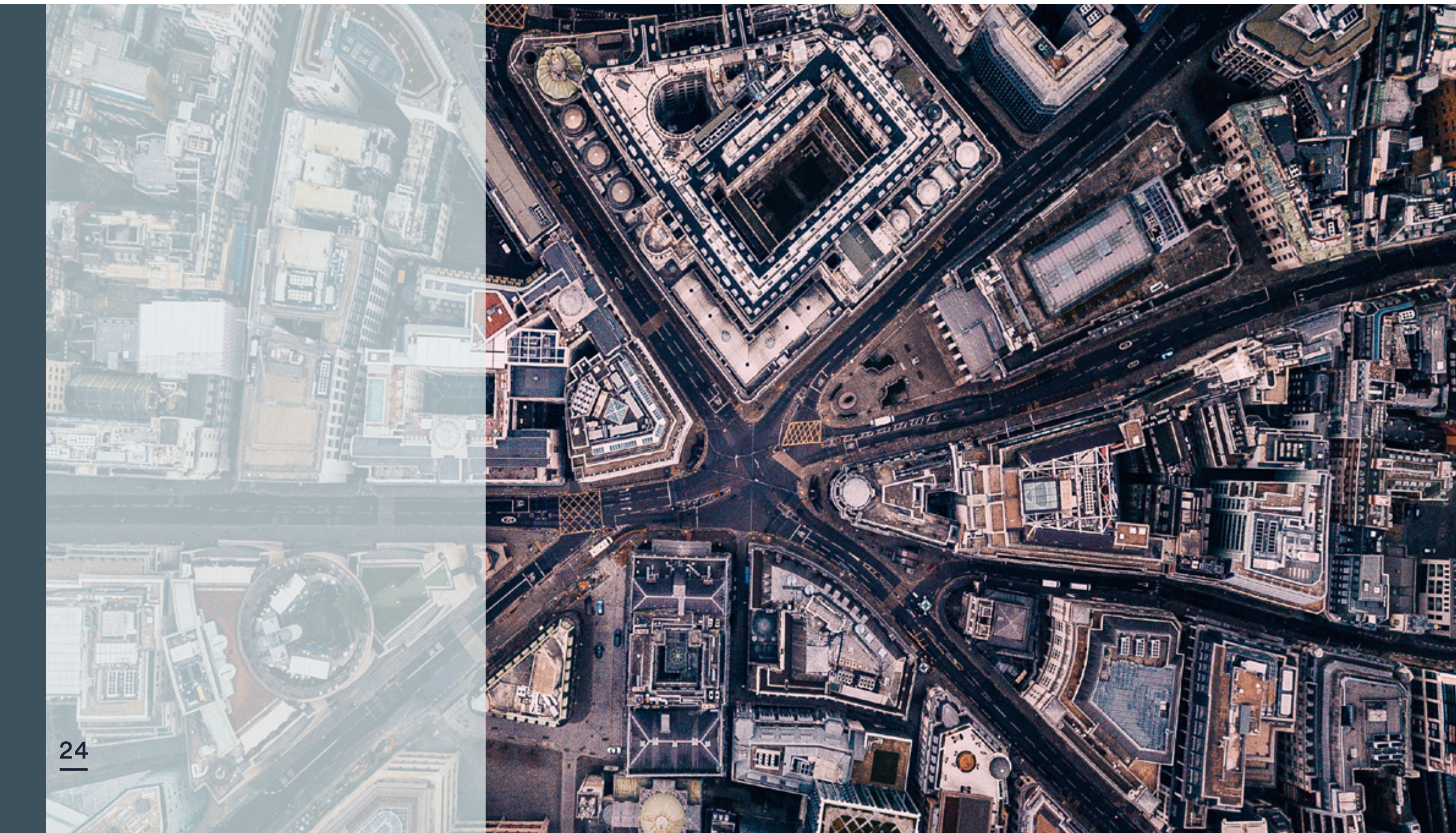
The "people issues"

Amid all the usual and strenuous negotiations over real assets, operations, and commercial due diligence, the most prudent dealmakers know also to scrutinize people strategies within the context of an M&A deal, appreciating that this can drive deal success in the long term.

Almost all respondents to our survey, 98%, say "people issues" such as talent acquisition, retention, culture, and leadership are an area of focus for their deal teams. Moreover, over half, 54%, identify this as a significant area of focus.

23. To what extent are 'people issues' such as talent acquisition, retention, culture, and leadership (beyond legal and compliance matters) a key area of focus for the deal team? (Select one)





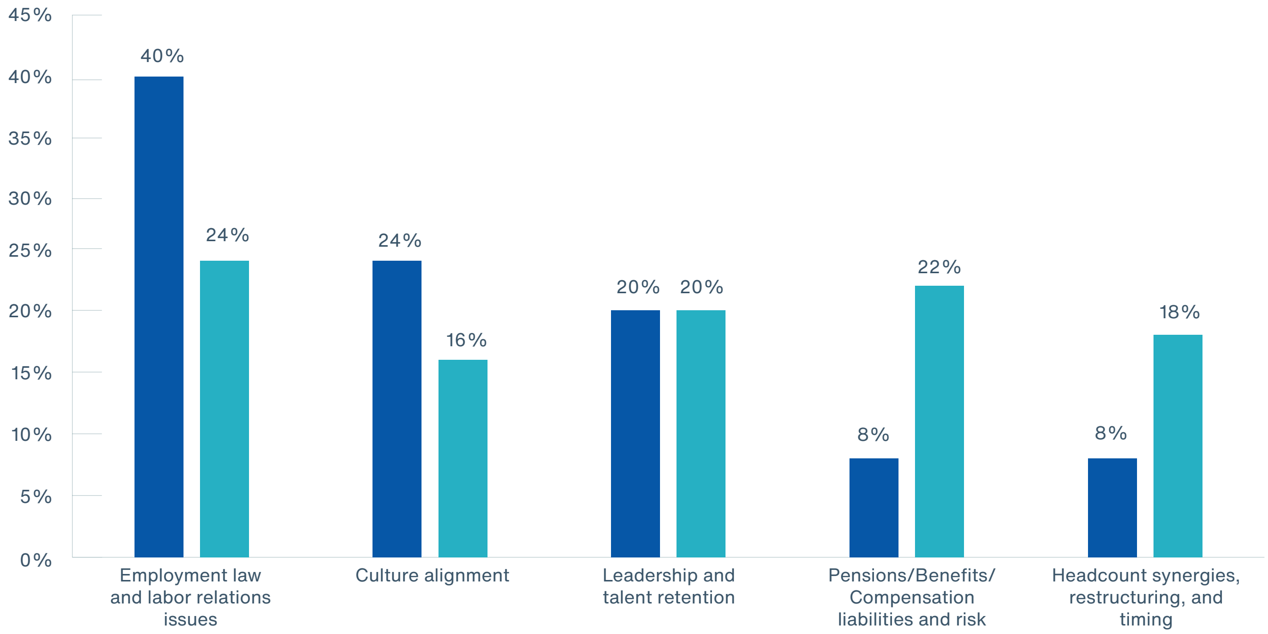
Culture issues have been a significant point of emphasis for dealmakers for quite some time. In particular, Aon is seeing the roles of diversity, equity and inclusion grow as central ESG considerations, as was illustrated in the earlier section in this report on ESG standards.

Among our respondents, 40% identify employment law and labor relations as the single biggest challenge in their dealmaking process relating to people issues, far ahead of the next most frequently cited factors.

Second-order issues including culture alignment (24% of primary votes), leadership and talent retention (20%), pension liabilities (8%), and headcount synergies (also 8%) will vary greatly according to deal type and the relevant jurisdiction. For example, Aon sees dealmakers emphasizing culture alignment in cross-border as well as cross-industry transactions. This occurs particularly frequently in relation to deals driven by digitalization or acqui-hiring.

The bottom line is that when people, programs, risks, and liabilities are not strategically quantified and managed, the ability to deliver on deal and business objectives is jeopardized. To ensure people issues are properly addressed, it is critical to raise these considerations early in the deal process and that they adequately reflect the expected complexity of the deal, laying the groundwork for long-term success.

24. What are the biggest challenges related to 'people issues' that you look to address in deals? (Select top two and rank 1-2, where 1 is the biggest challenge)



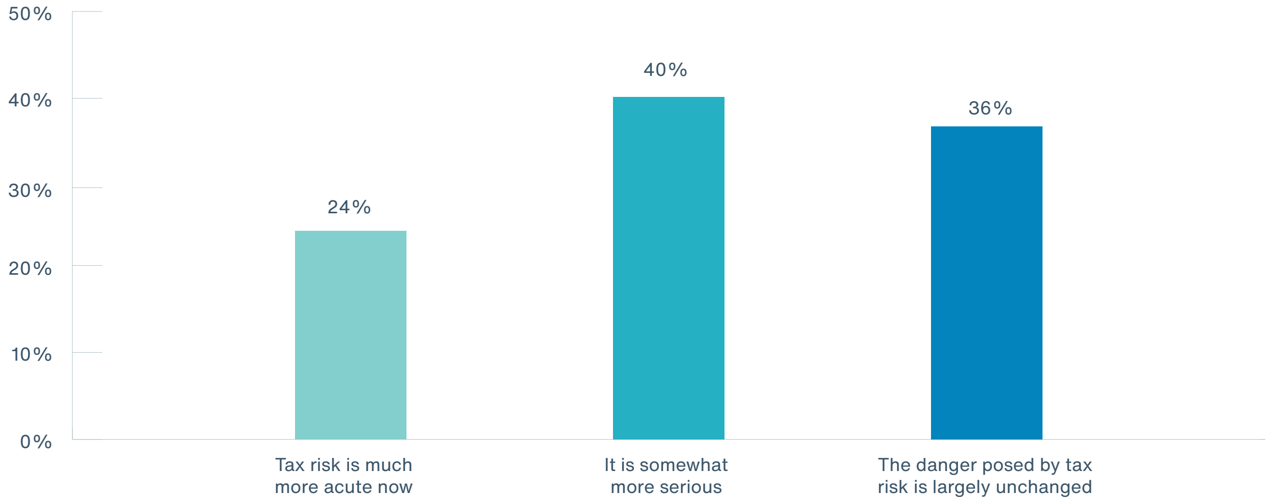
Tax risks

Among our respondents, it appears that dealmakers have shifted focus as to specific types of potential tax risks in transactions that pose the greatest threats.

In our 1H 2022 study, half of all survey participants said that tax risk was much more acute at the time than compared to the recent past, and a further 40% said it was somewhat more serious. In this survey, only 24% describe the tax risk as much more acute, and more than a third, 36%, believe the danger posed by tax risk is largely unchanged.

This finding is somewhat at odds with the significant increase in the number of tax-related risks that have entered the insurance market over the course of 2023 – though this may be the result of growing awareness of tax insurance among dealmakers.

25. How much more acute is tax risk to deal success now as compared to the recent past? (Select one)

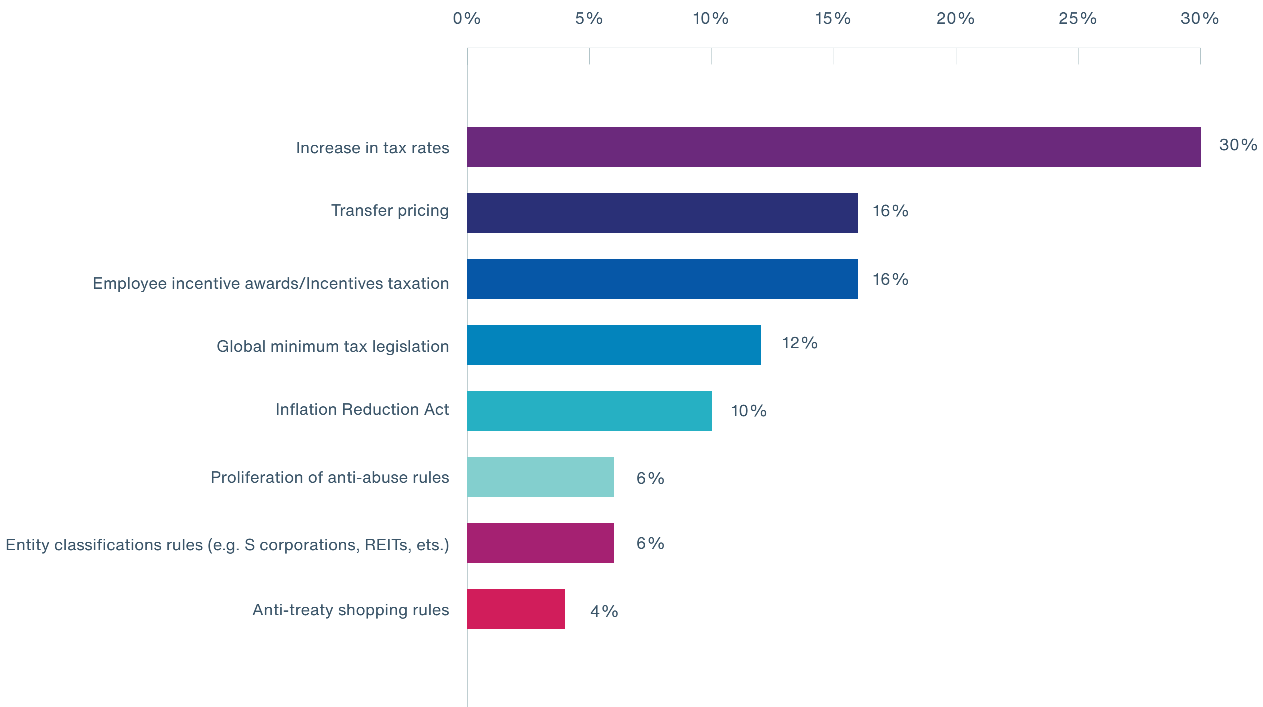


Almost a third of respondents, 30%, the largest such share, say that an increase in tax rates is the greatest tax-related concern for their organization. In our 1H 2022 study this was only the third-biggest concern that respondents were weighing in the balance indicating perhaps increased concern of potential new legislation on the horizon and related uncertainty.

Instead, the leading cause of anxiety in that survey was the proliferation of anti-abuse rules, which this year only 6% of respondents cite as their primary tax-related concern. Similarly, navigating entity-classification rules was a major point of emphasis in our 1H 2022 survey, but again only 6% of respondents this year feel it is worthy of note.

Conversely, the second-greatest concerns overall after rising tax rates are transfer pricing and employee incentive awards/incentives taxation, both of which accrue 16% of respondents' first-choice votes. Last year, these were the two least-concerning tax-related issues that respondents were asked to consider. This is consistent with Aon's experience with an increase in the number risks that have entered the insurance market in these areas over the last few years.

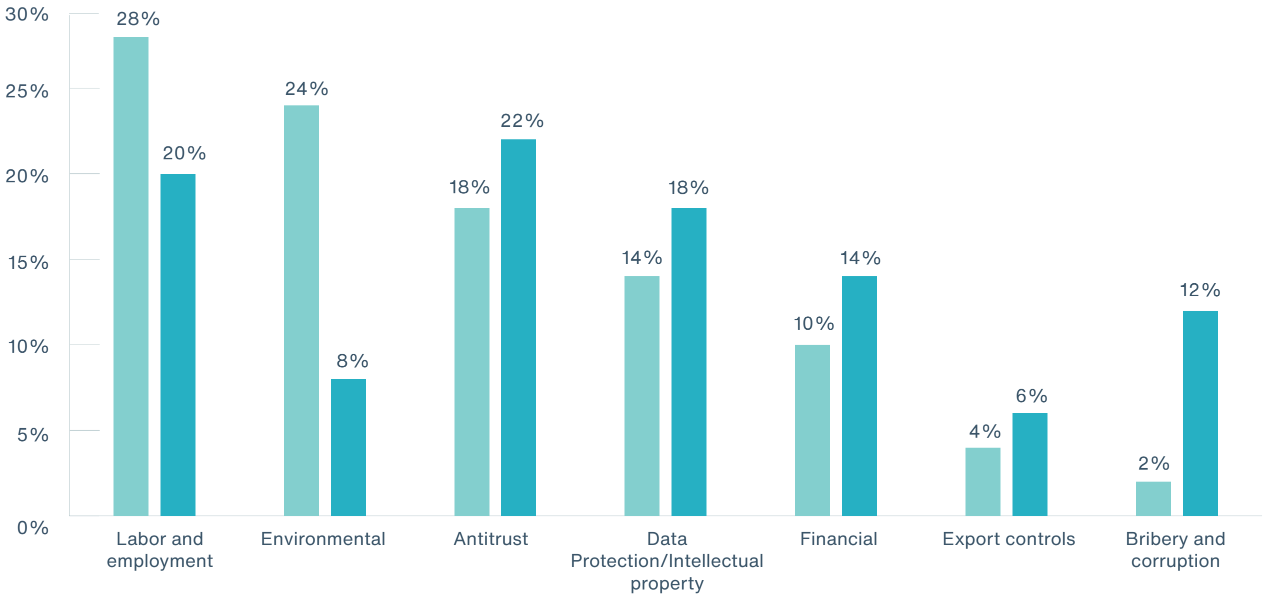
26. How much more acute is tax risk to deal success now as compared to the recent past? (Select one)



Litigation risks

Although a large share of respondents, 44%, believe the danger posed to deal success by litigation risk today is largely unchanged from conditions in the recent past, that leaves a small majority of 56% who view this as having grown more acute of late, including 12% who believe is much more acute at the moment.

27. Which of the following types of litigation creates the most concern in a deal? (Select top two and rank 1-2, where 1 is the most concerning type of litigation)



The type of litigation that causes the most anxiety in a deal relates to labor and employment law, being cited by 28% of respondents, the largest such share as their primary concern. This echoes the increasing foregrounding of people issues for achieving deal success that we explored earlier in this report, and bolsters the trend observed in our 1H 2022 survey, in which 22% of respondents, the second largest share in that study, cited labor and employment litigation as their number one concern.

In that 1H 2022 study, only 2% of respondents described environmental litigation as their primary concern. That share this year has jumped all the way up to 24%, surpassing even the increasingly thorny and headline-grabbing issues of antitrust regulation (18% of primary votes, down from 26% last year) and data protection/intellectual property (IP) (14%, down from 16%).

That issues relating to environmental litigation have grown so quickly clearly reveals the increasing weight that dealmakers are attributing to ESG and sustainability-related shortcomings, as we have illustrated in other sections of this report.

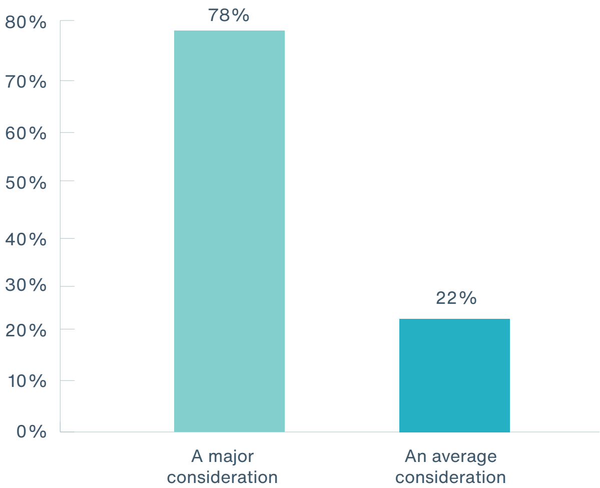
Intellectual property

As evidenced in our survey, Aon has seen its clients recognize the potential for both risk and opportunity from their IP and intangible assets in each lifecycle stage. In respect of innovation-driven industries specifically, the vast majority of dealmakers surveyed, 78%, agree that IP is a major potential value driver in M&A transactions.

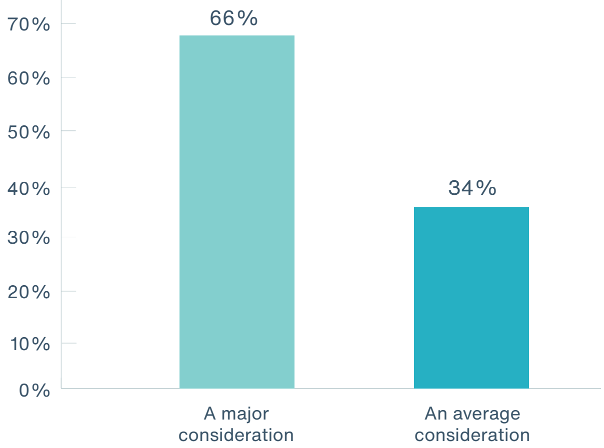
Savvy investors are seeking deeper perspectives on a target's IP portfolio, including the quality and relevance of the intangible assets, as well as any litigation risk that may result from possible infringement of third-party IP.

Relatedly, Aon has observed an increased interest in understanding strategic IP risk. All survey respondents agree this must be weighed in the balance carefully during M&A transactions, including 66% who say this is a major consideration.

28. Within innovation-driven industries, how would you rate the importance of intellectual property as a potential value driver in M&A transactions? (Select one)



29. Within innovation-driven industries, how would you rate the importance of intellectual property risk as a consideration for M&A transactions? (Select one)



Given IP's growing significance as industries become increasingly digitalized, dealmakers are looking to accumulate more information via a data-led approach to examine the relevant patent landscape and its constituent technology clusters. This allows them to better identify competitors and new entrants, and assess the breadth and validity of the patents.

On the sell-side, articulating value is paramount to maximizing the sale price. To that end, Aon has observed high-growth, IP-rich companies with a strong commitment to research and development trying to differentiate their approach to M&A.

One way they are accomplishing this is by leveraging a 'quality of IP' report that examines the full stack of intangible assets, including patents, trade secrets, know-how, software, and data. These reports can help position a company's intangible assets as a value driver, ultimately informing a deeper IP narrative throughout the transaction from price discovery through due diligence.

During the hold stage, these same investors aspire to build additional value through targeted investment in IP. In sectors ranging from climate tech through networking infrastructure, sponsors are seeking a deeper understanding of their portfolio companies' patent landscapes, identifying white space in which to strategically expand their IP portfolios and, thereby, grow value.

Conclusion: Key trends for the year to come

Although tight financing conditions and macroeconomic volatility are putting a damper on large-scale, transformational dealmaking, the findings illustrated in this report indicate that the M&A market expects to see a broad-based uptick in activity over the course of 2023. We anticipate that numerous operational and strategic imperatives will continue to drive dealmaking in core sectors, such as TMT, infrastructure and renewables, with more secure, advanced economies, and especially the US, likely to benefit the most.

This does not necessarily mean that sailing will be smooth – from ESG and cyber risk to market dislocation and geopolitical upheaval, rarely before have M&A strategies had their mettle tested by such varied risk factors simultaneously. Dealmakers must be proactive in controlling whatever risks they can, install mitigation plans for those outside their direct influence and use risk transfer solutions when available.

Especially in today's testy geostrategic and macroeconomic environment, much can change in a short period of time. But there are a few key trends that are likely to define M&A over the next 12 months, which dealmakers would do well to scrutinize as they devise their plans.

Pivot to smaller, strategic deals

Although deal volumes are generally trending upward, we have seen a chill cast over regulatory concerns of big-ticket transactions. Instead, a more programmatic approach to M&A will come to the fore, with minority transactions and alternative structures, including joint ventures and partnerships, becoming increasingly popular.

> **As the managing director of a German investment bank explains, "Getting buy-in for small deals will be considerably easier. There is more surety about the level of returns, and the impact of external conditions on business activities can be evaluated systematically."**

Playing up ESG propositions

ESG is now among the most important factors that dealmakers must weigh in the balance when undertaking transactions. For many, it is the most important factor to consider, given the uptick in scrutiny from regulators as well as consumers as devastating climate change events grow more common. Subpar ESG metrics could vaporize a deal – reviews will have to be more thorough than ever before, with dealmakers turning increasingly to expert external advisors to fill any resource gaps during ESG due diligence.

Constant improvement in cyber readiness

Technology is embedded in every facet of a modern business operations. Regardless of sector, it feels as though every company is now a technology company. But with increasing technology dependence comes a surge in cyber risks, and it is a constant battle for organizations to keep up with the rapid pace of innovation in technology tools – and the ways in which bad actors might exploit those developments. Digital transformation must be reinforced by proactive cybersecurity practices within companies and comprehensive cyber due diligence on the part of potential acquirers.

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