

M&A monitor

State of the market Q3 2018



Sector	Value \$bn	%
1 Consumer*	81	12
2 Energy and power	141	21
3 Financials	77	11
4 Healthcare	41	6
5 Industrials and materials	105	15
6 Infrastructure and transport	26	4
7 Real estate	76	11
8 TMT	135	20
Total	682	100



Sector	Vol	%
1 Consumer*	1,881	21
2 Energy and power	609	7
3 Financials	911	10
4 Healthcare	682	8
5 Industrials and materials	1,572	17
6 Infrastructure and transport	224	3
7 Real estate	668	8
8 TMT	2,304	26
Total	8,851	100

* Includes retail

Technology deals buck Q3 trend

Total deal values fell from \$1tn in Q2 to \$682bn in Q3, although M&A through the first three quarters of 2018 is up on the same period last year (\$3.023tn vs \$2.368tn). This dynamic is mirrored in the year's strongest performing sector, technology, media and telecoms (TMT), where deal values to the end of September outstrip 2017's annual total (\$696.5bn vs \$660.3bn) despite a \$95.8bn drop in value in Q3 to \$134.8bn. Within TMT, however, technology deals buck the trend, rising from \$80.7bn in Q2 to \$93bn in Q3. Buyers continue to target data assets, with notable transactions in 2018 including Strategic IDC's \$2.8bn acquisition of Global Switch Holdings (an owner and operator of data centres) and a consortium including Tencent Holdings paying \$3bn for an undisclosed minority stake in Walnut Street Group Holding (the holding company of the Pinduoduo e-commerce platform).

A new era for CFIUS

'National security has become the key factor governing foreign investment in the US,' wrote the *Financial Times* on 12 August. The article previewed two laws, passed the following day, that will boost the US government's powers to tackle perceived threats to national security posed by foreign investments and outbound technology transfers. One (the Foreign Investment Risk Review Modernization Act or FIRRMA) extends the jurisdiction of the Committee on Foreign Investment in the United States (CFIUS) to cover two key areas: real estate acquisitions close to sensitive facilities and non-controlling stakes in 'critical infrastructure, critical technology and sensitive personal data'. The other (the Export Control Reform Act or ECRA) places new controls on outbound transfers of so-called 'emergent and foundational technologies'. Together they underscore the importance of technological pre-eminence to the current US administration.

In some ways FIRRMA – by giving CFIUS explicit jurisdiction over transactions involving 'critical and sensitive businesses' – simply codifies what is already happening in practice. However, there are other aspects of the law that represent a departure from the norm.

- Today the committee only has jurisdiction over deals that confer 'control' of the target, a definition that is adjudicated solely by CFIUS as a broad ability to 'determine, direct, or decide important matters affecting the US business'.
- In the future, foreign bids of *any* size in a 'critical and sensitive business' will fall under the committee's purview. In addition, foreign *government* investors will be obliged to notify CFIUS if they intend to take a stake in such a business above a certain threshold. At present the filing system is voluntary.

Although not mentioned by name, the reforms are driven by concerns about the rising influence of China on the global stage. And while it's true that FIRRMA represents a big change, it's likely to be some time before its full effects are felt. There are immediate provisions that extend the time the committee has to review deals from 30 to 45 days. But its ultimate impact will be hard to quantify until the accompanying regulations have been passed, a process that could take up to 18 months.

In the meantime, it's likely that CFIUS filings will spike. The government may decide to backdate CFIUS's extended jurisdiction to when FIRRMA was enacted, and we're already seeing buyers whose deals will be captured by the incoming regime choose to alert the committee now. It will also be interesting to observe whether the committee takes up its option to pilot its new powers within the 18-month window. If it does, the results would be fed into the regulatory drafting process and would give some pointers as to the shape of the final guidelines.

Another point worth noting is that the reforms could have unintended consequences. Under FIRRMA, CFIUS must be notified of any acquisition of a 'substantial interest' in a critical or sensitive business by a buyer in which a foreign government also holds a 'substantial interest'. This obligation (which carries fines for non-compliance) will require the committee to set out exactly what it means by 'substantial interest'. At present CFIUS has discretion over how to interpret its jurisdictional limits. But in the future, the committee will need to be more prescriptive.

Financial sponsor M&A – top 3 deals with financial sponsor involvement



Where next for Asian investors?

In April we revealed the extent to which Chinese buyers had switched focus from the US to Europe in the face of hostile rhetoric from the White House. That trend has continued throughout 2018, with Chinese investment into Europe topping \$20.2bn to the end of Q3 (just \$4.3bn shy of 2017’s annual total). The highly publicised trade war between Washington and Beijing is likely to further curtail Chinese investment into the US, but Europe, too, is becoming a more challenging market for certain types of deal. The UK and Germany have recently introduced measures to clamp down on foreign acquisitions of critical infrastructure and high-technology businesses, so it will be interesting to see whether China’s European spree endures.

Japan appears to be benefiting from its neighbour’s troubles, with cross-border deal values through Q3 hitting \$129.9bn – the highest figure in a decade and more than two-and-a-half times more than in the whole of 2017 (\$48.7bn). But Japanese corporates are themselves not immune to overseas restrictions. As we have already outlined, reform of CFIUS will catch all foreign bids into the US targeting critical and sensitive businesses, while neither are Europe’s tighter foreign investment regimes China-specific.

If Chinese investment into Europe does decline, we might expect to see an acceleration of deals into ‘Belt and Road’ countries as the government looks for ways to support economic growth. (The Belt and Road Initiative is Beijing’s strategy to foster cross-border trade through infrastructure development across Asia, Africa and Europe.) A number of projects in Pakistan were put on hold in the run-up to Imran Khan’s recent election victory but these could progress in the months to come; likewise, further opportunities in Africa may rise up the agenda.

The continued rise of digital deals

Acquisitions of digital assets remain a significant driver of deal activity. This year alone we have seen General Dynamics snap up IT services giant CSRA for \$9.7bn; Roche spend \$1.9bn on oncology software developer Flatiron Health; a consortium of Chinese investors buy 25 per cent of data centre provider Global Switch for \$2.8bn; and Toyota take a minority stake in Grab Holdings.

Many of these cross-sector acquisitions involve companies whose value is tied to data (the CSRA deal, for example, saw General Dynamics inherit CSRA’s cyber security and analytics businesses). Acquisitions of this type require a different approach to M&A diligence. Regimes such as Europe’s General Data Protection Regulation mean buyers must assess the risk associated with any future use cases for personal data, while reviews of cyber resilience are vital to protect the target’s value. For more on how digital acquisitions are shaping M&A activity among the world’s biggest businesses, visit Freshfields Digital (www.freshfields.com/digital) to read our new report, which will be published soon.

Global M&A – value and volume

(Company nationality is determined by HQ location.)



* Includes domestic deals.

NB: All deal values include net debt of target.