M&A monitor – 2018 predictions

Freshfields Bruckhaus Deringer

We look ahead to six potential developments in 2018.

1

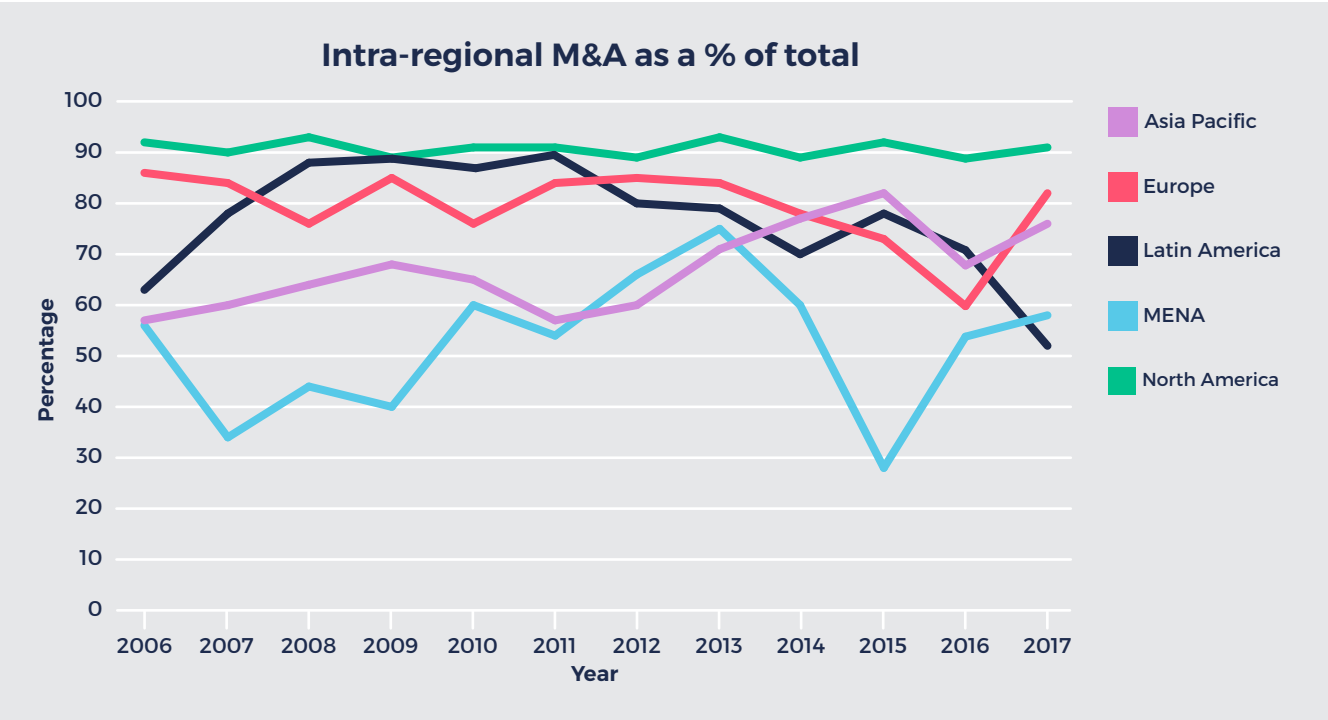
2018 will be the year of the intra-regional deal

Increasing protectionism has been one of the standout themes for 2017, and we believe it will drive more intra-regional M&A through 2018.

With many jurisdictions either implementing new controls on foreign investment or making greater use of existing mechanisms to protect national assets, the proportion of M&A spend focused intra-regionally in 2017 rose in every part of the world bar Latin America.

In Europe, we've already seen M&A activity creating 'European champions', and the current uncertainty around Germany's coalition government is unlikely to change this trend. The recent US tax reforms, which create incentives for US corporates to repatriate their offshore reserves, could heat up the market for US-to-US transactions or at least chill the use of offshore cash for non-US M&A. In addition to recent protectionist trends making some Asia-to-US/Europe deals more difficult, the Chinese government's clampdown on certain types of outbound investment – including by unwinding some historic overseas deals – coupled with its continued focus on its 'One Belt, One Road' strategy is likely to drive more Chinese M&A in Asia.

Cross-border acquisitions with strong strategic rationales will continue, but in a world where buying overseas is facing new challenges, many businesses may find the path of least resistance lies closer to home.



2

Regulatory complexity continues to put pressure on mega-M&A

There have been some spectacular mega-mergers in recent years and while 2017 has not been quite as strong as 2016, we have still seen a number of big-ticket highlights. However, increasing regulatory scrutiny and a shifting of the antitrust sands (for instance the DOJ's intervention on the vertical merger of AT&T/Time Warner and the EU's approach to R&D on the recently completed Dow/DuPont transaction) are leading to greater complexity and uncertainty.

It is also making deals more expensive. Over the 10 years from 2006 the average $10bn+ deal took 252.97 days to close, and today pre-close periods in excess of a year are increasingly common. These elongated approval processes can significantly increase a cash bidder's financing fees and expenses and lead to greater pressures on the target's (and sometimes bidder's) business during this 'limbo' period. With all-stock deals seemingly falling out of favour (according to Dealogic, 2017 had the lowest level of all-stock deals since it started collating data in 1995), bidders' ability to effectively finance mega-deals over increasingly lengthy periods will see greater focus on multi-faceted financing structures.

3

A shift in activism?

Hardly a week went by in 2017 without shareholder activism making the headlines.

The most high-profile campaigns were invariably the most aggressive, from Nelson Peltz *vs* Procter and Gamble to Elliott *vs* Akzo Nobel and Arconic. But more consensual approaches also yielded results – Nestlé, for example, agreed to many of Dan Loeb's demands without a costly public fight. Peltz and P&G reportedly spent more than $200m combined on their lengthy proxy battle, and while Peltz has not yet secured a seat on the board, P&G's CEO David Taylor has responded to at least some of his demands by agreeing to cut costs and shed more than half the company's brands.

With near-record sums under activist management – and funds like Trian continuing to generate double-digit returns – successful activists will be under no pressure from their limited partners to change tack. As a result, where possible we expect more businesses will seek to constructively engage rather than resist in 2018.

We expect large market-cap consumer companies to remain in the activists' sights given the widespread public rejection of political and corporate institutions (and by association certain big brands). And the pressure for digital transformation among industrials is likely to cause activists to target companies with low R&D spend or where innovation pipelines have stalled – M&A and/or structural reform will frequently be cited as the solution to activist concerns.

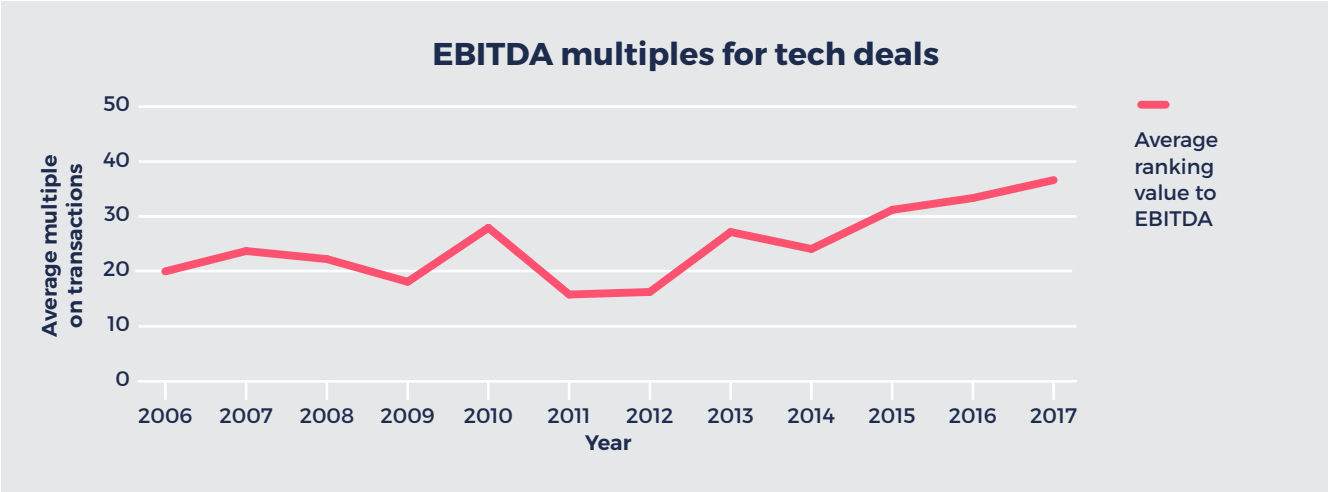
4

M&A to achieve digital transformation

With growing pressure on companies in every sector to digitise their business models, M&A is often the quickest way to move up the curve.

Market data reveals the extent to which non-tech businesses are using acquisitions to boost their digital capabilities – since 2012, the proportion of tech deals done by non-tech companies has been rising and in 2017 hit a 10-year high of 59 per cent. But it's the multiples being paid for those businesses that really raises eyebrows. In 2006, the average tech company was bought for a healthy 19.9xEBITDA. This year that figure has risen to a staggering 36.6xEBITDA, another 10-year high.

Looking ahead to 2018 there is no reason to think that competition for tech assets will dissipate, and financing solutions for these increasingly expensive tech deals are constantly evolving. The ECB recently issued guidance that effectively sets an EBITDA-limit on loan financings for European banks. The US has similar leveraged loan guidelines in place, although they are currently under review. If they are relaxed or repealed, US banks would be able to join their currently unregulated financing source counterparts in funding the higher-multiple deals of the type we are seeing in tech. Whereas in the EU, non-bank investors are well placed to increasingly dominate this growing market.



5

Change at the top to drive healthcare transactions?

In recent years healthcare M&A has seen a focus on specialisation.

Big pharma has been divesting non-core assets, focusing its R&D investment on defined therapeutic areas and outsourcing production, and we expect this trend to continue because the market rewards it. Transactions will continue to be vital to drive innovation and boost product pipelines, and we are likely to see further intense competition for drugs that have cleared Phase I or Phase II trials as buyers seek to de-risk their portfolios. A big unknown, however, is whether President Trump will make good on his repeated vow to cut the price paid by Americans for drugs – if he succeeds it could have a significant impact on the sector and influence R&D decisions and deal-making over the longer term. US tax reform is also likely to stimulate healthcare transactions given the size of US pharma companies' offshore reserves, and the fact that many of the biggest pharma players have newly installed CEOs could similarly lead to an uptick in M&A. While the sector has seen a lot of deals in recent years, a decade has passed since the last big pharma merger (Wyeth/Pfizer in 2009); 2018 could therefore be the year we see another mega tie-up.

Big pharma players with newly installed CEOs within the last year

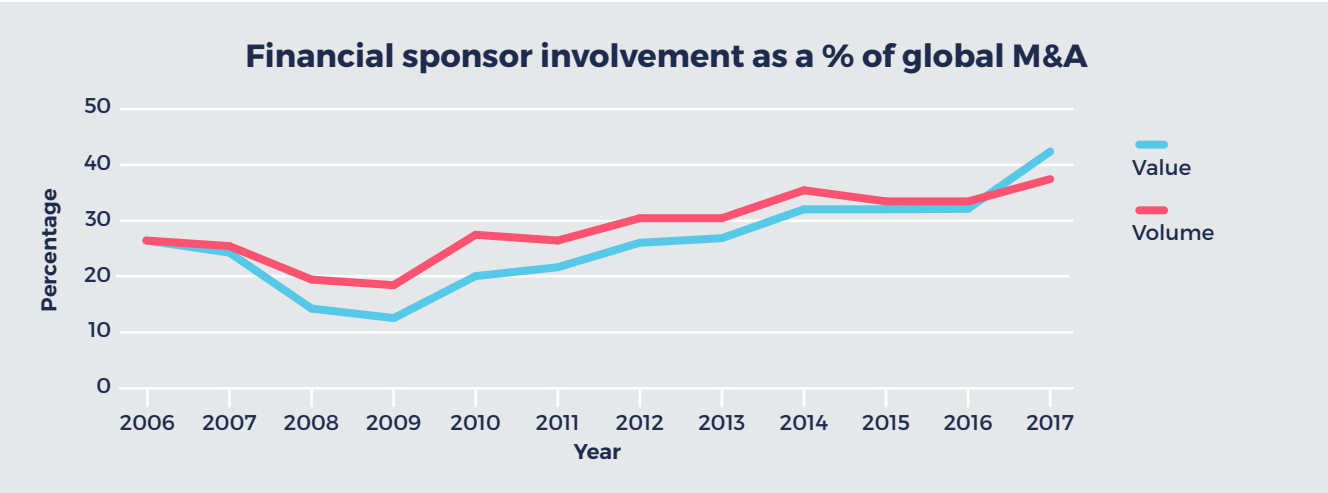
Biogen	gsk	Lilly	Novartis	TEVA
Michel Vounatsos	Emma Walmsley	David Ricks	Vasant Narasimhan	Kåre Schultz

6

PE boom shows no signs of slowing

We are in the midst of another long-cycle private equity boom, with financial sponsor activity as a proportion of total M&A hitting new highs for both volume and value in 2017 (38 per cent and 43 per cent, respectively).

We expect the next 12 months to bring more of the same, with PE sponsors flush with cash thanks to record levels of dry powder and high liquidity in the debt markets competing for ever-larger deals either alone or in partnership with other sponsors. The value and volume of bolt-on deals undertaken by PE houses rose by 172 per cent and 86 per cent, respectively, between 2010 and 2016, and this trend for sponsors to create market-leading portfolio companies is here to stay. We will also see private equity continue to target complex carve-out acquisitions and increase their focus on listed companies, especially those with business models ill-suited to being public.



Global M&A YTD activity by sector

	Sector	$bn	%
1	Consumer and healthcare	638	20.19
2	Energy and natural resources	519	16.44
3	Financial institutions	419	13.27
4	General industries	477	15.10
5	Infrastructure and transport	235	7.44
6	Real estate	414	13.11
7	Telecoms, media and technology	456	14.45
	Total	**3,159**	

	Sector	Vol	%
1	Consumer and healthcare	8,324	19.15
2	Energy and natural resources	4,329	9.96
3	Financial institutions	4,676	10.76
4	General industries	10,817	24.88
5	Infrastructure and transport	2,671	6.14
6	Real estate	3,838	8.83
7	Telecoms, media and technology	8,815	20.28
	Total	**43,470**	

Global M&A YTD – value and volume

(Company nationality is determined by HQ location.)

Global

M&A value
$3,159bn

M&A deal volume
43,470

Top 3 deals

1	Aetna/CVS Health (CHG)	$67.8bn
2	Abertis Infraestructuras/ Atlantia (ITG)	$34.6bn
3	Rockwell Collins/ United Technologies (ITG)	$30.2bn

Inbound:
most targeted countries

USA 11,935 deals	$1,380bn
China 5,090 deals	$420bn
UK 2,398 deals	$167bn

Outbound:
most acquisitive countries

USA 11,569 deals	$1,315bn
China 5,050 deals	$485bn
UK 2,468 deals	$176bn

USA

M&A value
$1,380bn

M&A deal volume
11,935

Top 3 deals*

1	Mead Johnson Nutrition/ Reckitt Benckiser Group (CHG)	$17.8bn
2	Panera Bread/ JAB Holding (CHG)	$7.5bn
3	Cavium/Marvell Technology Group (GIG)	$6.3bn

Inbound:*
countries investing into US companies

UK 235 deals	$48bn
Canada 428 deals	$42bn
Japan 105 deals	$18bn

Outbound:*
countries US companies are investing into

UK 304 deals	$24bn
Canada 312 deals	$18bn
Israel 36 deals	$16bn

*excluding US domestic deals

Europe

M&A value
$684bn

M&A deal volume
12,762

Top 3 deals

1	Abertis Infraestructuras/ Atlantia (ITG)	$34.6bn
2	Logicor Europe/ China Investment (ITG)	$13.7bn
3	Worldpay Group/ Vantiv (TMT)	$11bn

Inbound:
counties investing into European companies

UK 2,205 deals	$124bn
France 1,810 deals	$108bn
USA 874 deals	$74bn

Outbound:
countries European companies are investing into

UK 2,013 deals	$115bn
USA 661 deals	$104bn
France 1,692 deals	$78bn

Asia Pacific

M&A value
$841bn

M&A deal volume
14,259

Top 3 deals

1	Toshiba Memory/ KK Pangea (Bain Capital) (GIG)	$17.9bn
2	Global Logistic Properties/ Nesta Investment Holdings (RE)	$16.4bn
3	Idea Cellular – Mobile Business/Vodafone Group – Vodafone India Assets (TMT)	$11.6bn

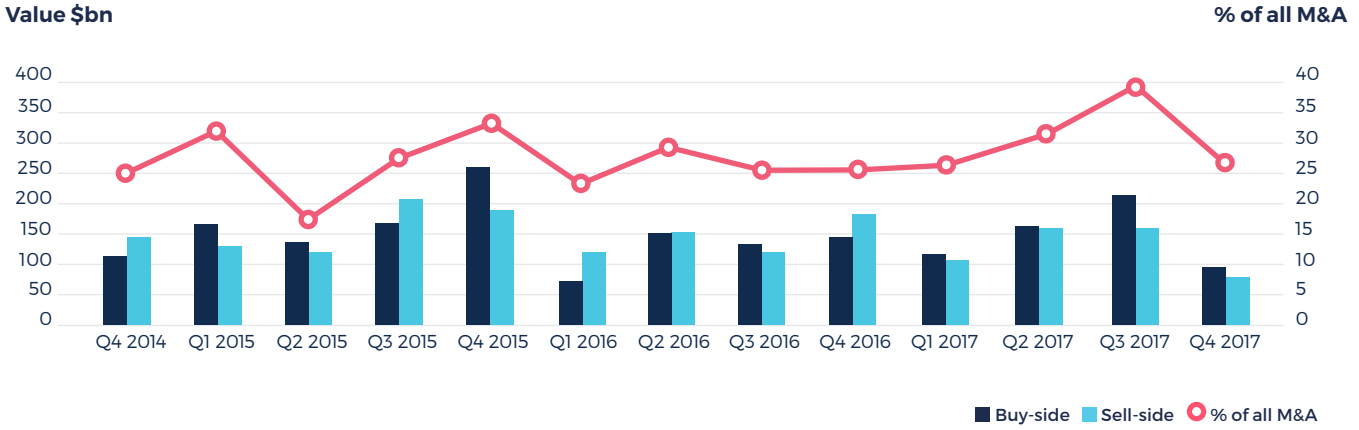
Inbound:
countries investing into Asian companies

China 4,867 deals	$441bn
Hong Kong 982 deals	$91bn
Japan 2,448 deals	$77bn

Oubound:
countries Asian companies are investing into

China 5,125 deals	$493bn
Hong Kong 1,113 deals	$106bn
Japan 2,669 deals	$101bn

Financial sponsor M&A



CHG – Consumer and healthcare | ENR – Energy and natural resources | FIG – Financial institutions
GIG – General industries | ITG – Infrastructure and transport | RE – Real estate | TMT – Technology, media and telecoms

Source: Thomson One (Deals). Data reflects 1 January – 11 December 2017