M&A

The Necessary Driver *for* Global Growth in 2017

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Global mergers and acquisitions smashed a single-month record in October 2016, registering some $500 billion in announced transactions. About 60% of that total took place in the U.S.

AT&T's proposed $85.4 billion acquisition of Time Warner grabbed the biggest headlines, but on a single Monday hours after, four other companies announced multibillion-dollar deals: China's HNA Group will pay $6.5 billion for a 25% stake in Hilton; Rockwell Collins is acquiring B/E Aerospace for $6.4 billion; TD Ameritrade bid $4 billion for Scottrade; and American Midstream Partners is taking over JP Energy in a $2 billion pipeline company merger. Then, on the last day in October, CenturyLink Inc. announced it would acquire Level 3 Communications Inc. for $34 billion, and General Electric and Baker Hughes said it would merge oil and gas services businesses in a $32 billion deal.

SINGLE-MONTH RECORD

$500 Billion

In Announced Global M&A Transactions

October 2016

Even all that doesn't tell the entire story. Joining this past October's deals list were dozens of smaller transactions that ranged from the tens of millions to $1 billion. Mostly flying beneath the radar, they extended far and wide, geographically and by sector. Within 24 hours of each other, for example, Massachusetts-based Altra Industrial Motion Corp.'s announced it would acquire Stromag, which makes clutches and brakes from a base in Unna, Germany for $215.5 million; and Wipro said it would purchase fellow IT services firm Appirio, linking India with Indianapolis, for $500 million.

True, the total value of deals so far this year has decreased compared to the same period last year. According to Dealogic, global M&A through October totaled 31,100 deals and $3.15 trillion, down from the record-setting 34,200 deals totaling $3.82 trillion in January-October 2015. Some would also argue that October was an aberration and reflected a pre-election rush.

However, there's a much more compelling narrative and one that bodes well for sustained M&A well into 2017 and beyond.

For companies that want to achieve better topline growth, M&A is becoming the necessary driver. This increasing reliance on acquisitions reflects a global economy that contains the precise balance needed for dealmaking. There's enough stability to engender confidence, but not enough economic sizzle for purely organic growth. Interest rates remain low and cash reserves remain high, so deals-related capital is abundant. And, stakeholders support mergers and acquisitions as necessary.

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"Inorganic growth and the expansion of business through M&A is now the norm. Not only is it accepted, it's very much expected by the market and by shareholders," said Matthew Porzio, vice president of global strategy at Intralinks. Mergers and acquisitions have become "the new path to growth, to innovation, to profitability," he said.

What's more, economists predict the macroeconomic conditions that favor M&A—a relatively stable, low-growth environment—will continue for some time. The global economy isn't expanding terribly fast. Growth has declined since 2012, but it is secure enough that neither executives nor boards worldwide are spooked by visions of widespread turmoil or recession. While individual countries may turn in stellar economic performances in a particular year, global GDP in aggregate is likely to remain in the low single digits. The International Monetary Fund now projects 2016 global GDP will slow to 3.1%, from 3.3% in 2015, and increase slightly to 3.4% in 2017.

The U.S. continues to be the single biggest player in M&A. Both targets and acquirers, however, cut a wide swath across many, many different countries and regions. Dealmaking has gone truly global.

True, there's heightened political uncertainty these days, first with the vote by Britain to leave the EU and then with the surprise election of Donald Trump as president. Some M&A advisers now predict a wait-and-see period, and the Brexit vote triggered some temporary falloff. Worst case, if, for example, Trump were to provoke a trade war with China or demand the end to NAFTA, all bets are off. But not many expect such radical action once Trump begins to govern in late January.

COMPANY GROWTH

45% Inorganic

On Average

EY Report

Regulatory-related unpredictability is an issue as well. In the U.S., Trump's business background clashes with his populist rhetoric. But few predict regulators in the new administration will come down harder than regulators did under Obama. In Europe, Brexit will necessitate a new British regulatory regime, although Britain in the past has been a staunch defender of M&A.

However, many companies, themselves, remain upbeat when it comes to M&A.

According to an EY report from October, 57% of the more than 1,700 executives surveyed said they plan to make an acquisition in the next year, “a clear signal of their determination to counter the low-growth, disruptive environment.” What’s more, just under half of these companies have more than five deals in the pipeline.

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These findings dovetail with another key point in the EY report: On average, some 45% of a company’s growth will be inorganic, those surveyed believe. In other words, acquisitions are expected to be almost co-equal to current business as a growth driver.

Last year, there were more than 44,000 M&A-related transactions globally, according to the Institute for Mergers, Acquisitions and Alliances, a Vienna, Austria-based organization. According to Dealogic, total deal value in 2015 topped $5 trillion, a record.

That kind of bullishness continues. In its latest projection, Intralinks forecasts the total number of announced deals this year will be 3% higher than in 2015, making 2016 the biggest deal year on record, surpassing 2007. Just as importantly, Intralinks predicts that Q1 2017 will register a 5% growth on the number of deals over Q1 2016.

With so many different transactions, it’s impossible to generalize too much about deal type and strategy. However, some important trend lines have emerged:

SECTORS ARE BLURRING

Companies are making “increasing and deeper incursions into adjacent or unrelated industries,” said EY in its latest report. That, the consultancy said, has become a prominent feature of the current M&A market. A Deloitte study, as well, underscored this blurring of boundaries. Deloitte ascribed the change to technology, which is both penetrating and reshaping traditional business models.

When companies mount incursions into new businesses, they need guidance. So, acquisitions become critical for gaining what EY terms “onboard expertise.” It may mean acquiring smaller businesses with a particular talent pool, or even rivals, EY said.

$68M Investment

Retail & Merchandise / September 2016

Target	*Investor*
idX Corp.	**Universal Forest Products**

These kinds of section-blurring acquisitions roam the spectrum in size and sector. In November, Samsung Electronics announced it would pay about $8 billion for Harman International Industries, a major player in automotive-related infotainment. This acquisition gives the Korean consumer electronics giant, best known for its smartphones, an immediate bulwark in automotive electronics, which, within 10 years, Samsung said, will surpass $100 billion worldwide.

Two months before, Universal Forest Products acquired, for $68 million, idX Corp., a customized merchandising solutions concern that designs, produces and installs in-store displays,

$760M Investment

Technology / September 2016

Target	*Investor*
IronPlanet	**Richie Bros. Auctioneers**

including shelves and signage. Universal Forest makes wood products, including packaging and industrial materials. The Grand Rapids, Mich.-based company sees idX as an entry point into adjacent markets, providing it with new opportunities to provide products already being made.

The goal is to acquire new businesses that may be tangential, but not strictly a consolidation. In May, for example, Transdigm Group said it would pay $1 billion for Data Device Corp. Based in Cleveland, Transdigm makes aircraft components, while Bohemia, N.Y.-based DDC manufactures aircraft-related avionics, notably databus and power controls.

There's a link to many of these sector-bending acquisitions. "The convergence of technology across industries is adding a new dimension to dealmaking," according to the Deloitte study, citing banks that move into financial technology, or automotive companies attempting to develop self-driving cars.

M&A IS THE NEW R&D

Technology is driving a significant amount of acquisitions. And it's not just a case of one tech concern buying another. Companies are being acquired for their intellectual property, for new technologically advanced processes, and for their tech-savvy personnel. These targets run the gamut of sectors and industries.

Examples abound. In November, Pentair plc subsidiary Pentair Aquatic Eco-Systems Inc. announced it was buying Icelandic concern Vaki Aquaculture Systems Ltd., which has developed cutting-edge technology in biomass estimation for aquaculture. Two months before, Ritchie Bros. Auctioneers, which specializes in the sale of heavy machinery, said it would acquire IronPlanet, an industrial ecommerce site, for about $760 million.

Again, take the Samsung-Harman deal. Analysts noted that Harman brings with it to Samsung some 8,000 software engineers.

Innovation is necessary to reshape growth, EY concluded. The fastest path is through acquisitions.

M&A SHOULD NO LONGER BE DIVIDED BETWEEN STRICTLY HORIZONTAL AND VERTICAL DEALS

More executives and their boards demand that acquisition targets bring something extra than merely a bigger market share or an additional slice of the supply chain. They must provide a new product, badly needed expertise or complementary market opportunities.

That doesn't mean consolidation plays are obsolete, but they are becoming more directed. Healthcare companies, for example, will continue to merge, although acquired entities tend to bring with them an added specialty. For example, WellCare Health Plans said in November, that it will acquire Universal American Corp. for $800 million. Universal American specializes in Medicare-related health plans, a portion of the HMO market WellCare wants to bolster.

"It is this idea of acquiring that new expansion point, which is based on [a company's] business strategy," Porzio said. "It's tangential enough, but it's opportunistic."

PLATFORMS ARE THE NEW CONGLOMERATES

While some analysts framed AT&T's bid for Time Warner as a classic example of delivery wanting to marry content through M&A, a better way to frame the landscape might be to look at platform building, said Michael Schrage, research fellow at the MIT Sloan School of Management's Initiative on the Digital Economy. Think Google, Facebook and Amazon.com. These new corporate powerhouses have fashioned a central and cohesive platform, driven by technology, which allows users and customers to move seamlessly between what is often termed "experiences." Acquisitions they have made are structured to form a part of the platform. "The single biggest question facing AT&T is whether it manages itself as a content and distribution network or turns itself into a platform, the way Facebook and Google have done," Schrage said.

WITH INDIA A FAVORED ASIA-PACIFIC DESTINATION, CHINA IS BECOMING A GLOBAL M&A POWERHOUSE. JAPAN COULD ONCE AGAIN BECOME AN OUTBOUND M&A FORCE TO BE RECKONED WITH AS WELL

As China's economic engine slows somewhat, Chinese companies will look offshore for more of their own growth. M&A is becoming an increasingly potent tool and natural resources companies are no longer be the only targets. Not by a long shot. Just look at China National Chemical Corp.'s proposed $43 billion acquisition this year of Swiss agribusiness giant Syngenta AG or the $5 billion purchase by the Chinese home appliance company Midea Group of the German robotics manufacturer Kuka AG.

RECORD M&A SPEND

$46 Billion

During Q1-Q3 2016

Eclipsing all of 2015

iChina is scouring the neighborhood as well-looking for deals. According to a survey by law firm Herbert Smith Freehills, almost half of the companies polled see Southeast Asia as their top investment destination over the next three years. That appetite became apparent in April, when Chinese e-commerce behemoth Alibaba paid $1 billion for a controlling stake in Singapore's online shopping site Lazada.

India has turned in a stellar economic performance with a projected 7.6% growth rate in 2016. The same is expected in 2017, although the government's surprise crackdown on illicit money may temporarily dampen some economic growth. The booming economy has translated into a record M&A spend this year, with $46 billion during the first three quarters far eclipsing all of 2015. Although the country's M&A market tends to be dominated by domestic players, it has attracted vigorous investment activity inbound, as well as Indian companies acquiring companies abroad. In addition to its acquisition of Appirio, Wipro paid $460 million in February for Tampa, Fla.-based HealthPlan Services.

Japan's M&A appetite is nothing new. In the late 1980s and early 1990s, Japanese companies, bolstered by negative interest rates and a strong currency, aggressively acquired overseas companies, often paying huge premiums. But last year, with a rapidly aging population, domestic growth once more static and stimulus capital flowing, Japanese companies once again became enthusiastic acquirers. That

BIGGEST DEAL OF THE YEAR

$36.1 Billion

SoftBank Group's acquisition of British semiconductor maker ARM Holdings

July 2016

slowed during the first half of this year, but is likely to bounce back.

Japanese Prime Minister Shinzo Abe "has been pushing for internal investment, but the growth has been tepid, so Japanese companies are looking outside and taking advantage of growth markets elsewhere," Porzio explained.

The biggest deal so far this year: SoftBank Group's $31.6 billion acquisition announcement in July of British semiconductor maker ARM Holdings.

Japanese and Chinese companies could well become spirited competitors for overseas acquisitions. Last year, for example, Japan's Hitachi and China's CNR Corp. went head-to-head over Italy's AnsaldoBreda rail line and Ansaldo STS rail switching business. Hitachi won and paid about €1.9 billion.

EUROPE WILL BECOME A MAJOR SOURCE FOR DEALS ONCE MORE

According to Intralinks estimates, early-stage M&A during Q3 in Europe, Middle East and Africa grew 13%, the highest of any region. Within Europe, by far the biggest component, M&A, was broadly based, and Britain bounced back after the Brexit vote.

Deals are spread across Europe, although there are some obvious laggards, including Greece and Russia. Take Spain, for example, which is recovering from a sharp and prolonged downturn. In April, French e-commerce company Vente-Privee acquired the Spanish fashion etailer Privalia for $560 million. A month later, eBay paid $165 million for Bilbao-based Ticketbis, as a vehicle for extending the StubHub into Europe. In Poland, another booming M&A market, Liberty Global announced in October that it would spend $760 million to acquire Multimedia Polska SA. In June, Hong Kong-based environmental services firm Everbright International bought Polish waste management company Novago Sp Z.o.o for €123 million.

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DEALMAKING IS GETTING MORE PROFESSIONAL AND MORE TARGETED

The days when M&A was widely used as an indiscriminate ad hoc tool for boosting assets are fading. As they gain experience, an increasing number of corporate dealmaking teams, and the executives behind them, are far more disciplined than in the past. Advisers, aided by technology, are better equipped to assist. As McKinsey & Co. proclaimed in a report a few years back, M&A can become a "competitive advantage" for corporations.

The speed in which deals can get done is accelerating, but boards are becoming more confident that the chances for success are greater. "M&A can be that growth driver, and it has less risk than ever before," Porzio concluded. ■