Return of the Megadeal

High-dollar transactions are making a comeback in 2018

1 What do you think will happen to the number of megadeals (value of US$4bn or more) globally over the coming 12 months?

If there is one phrase that could define dealmaking so far in 2018, it is this: megadeals are back. Through the first two months of the year, there were already 25 M&A deals valued at US$4bn or more, setting a faster pace for such deals than in either of the last two years, according to Mergermarket data.

Corporations flush with cash and financial buyers with dry powder are increasingly seeking high-value targets for acquisition. In early 2018, several big-name companies have made bold bets, such as French pharmaceutical giant Sanofi's US$11bn purchase of US-based hemophilia drug maker Bioverativ – one of three megadeals in the pharma and biotech space already this year.

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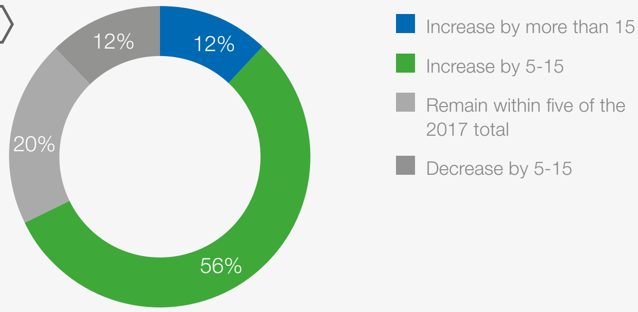


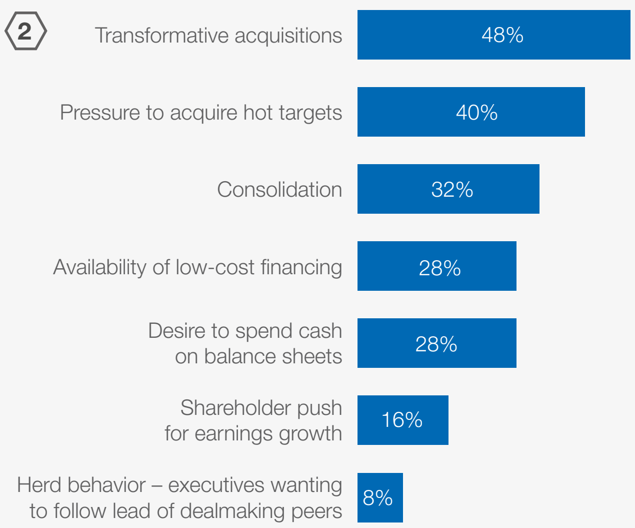
In our survey, respondents broadly said that they expect more megadeals in the year ahead, with 12% saying they think the number will increase by more than 15 and 56% arguing there will be an increase of 5-15 transactions. Just 12% believe there will be a decline in the number.

To put the figures in perspective, there were a total of 129 deals globally worth US$4bn or more in 2017 and 133 in 2016, down from a peak of 158 in 2015. The total value of such deals last year was US$1.36 trillion.

A managing director at a boutique investment bank headquartered in the US said he expected the number of megadeals to rise later in 2018 after a tumultuous start to the year for equity and fixed income markets. “Companies will use a wait-and-watch approach for the initial half of the year,” the banker said. “Executives are still concerned about market conditions and will only push for megadeals in the latter half of the year. We see the number of such transactions not increasing more than 10 overall.”

2 What will be the main drivers of megadeals over the next 12 months? (Select top two)

Not every megadeal is made alike – acquirers’ motivations can vary widely depending on the circumstances. In the case of one of last year’s blockbuster deals, pharmacy operator CVS’s US$67.5bn purchase of health insurer Aetna, the two firms are seeking to transform themselves into a new breed of healthcare company that lowers costs and changes the way patients receive care.



In the related sector of pharma and biotech, one of this year’s megadeals – US cancer drug maker Celgene’s US$8.1bn bid for Juno Therapeutics – exemplifies a different kind of transaction: the acquisition of a hot target. Juno is developing cutting-edge tools to fight cancer known as cell therapies, and Celgene wanted to keep up with rivals such as Gilead Pharmaceuticals that have already done deals for companies in the segment.

Our survey respondents expect these two motivations to spur on megadeals the most over the coming year, with 48% saying transformative acquisitions will be one of the top two types of megadeals and 40% saying acquisitions of hot targets will be. Nearly one-third (32%) said they think consolidation will be a top-two driver – as seen in the highly active media industry with deals such as Disney’s US$68.4bn purchase of Twenty-First Century Fox in December 2017.

One of our survey respondents, a managing director at a New York-based investment bank, said he thinks megadeals are essentially always meant to be transformative in nature. “I would say the main driver of megadeals has always been transformative acquisitions, and this will remain the case over the next 12 months,” he said. “Companies will need to transform their business models in order to keep pace with changing market conditions, as well as acquire businesses that will foster innovation.”

3 Which sectors will have the most megadeals over the coming 12 months? (Select top two)

Every sector seems to have an era in which megadeals abound, such as consumer in 2014 (Albertsons-Safeway, Dollar Tree-Family Dollar) and financial services in 2015 (KeyCorp-First Niagara, CPPIB-Antares Capital). And then some sectors, such as energy, mining and utilities (EMU), play a leading role in almost every period. Last year, the natural resources sector had 26 megadeals, more than any other industry.

Over the next 12 months, survey respondents expect this trend to continue: 52% said they expect the

EMU sector to be one of the top two sectors for megadeals, while 44% said technology will be among the top two most active as well.

In recent months, the EMU industry has indeed witnessed significant transactions, especially in the embattled power sector. In January 2018, East Coast power companies Dominion Energy and SCANA announced a US$14.3bn merger as SCANA reels from a failed US$9bn nuclear project in South Carolina. That deal followed the announced US$10.6bn tie-up between Texas-based power producers Vistra Energy and Dynegy in October 2017, a deal driven by the companies' need to minimize costs as electricity prices remain low.

"The energy and utilities sector will witness a major boost in megadeals," said the director of corporate development at a US consumer company. "There are a number of players in the US who will look to merge or do deals due to ongoing lower gas prices and rapidly changing dynamics in the industry."

The technology sector has also had several megadeals already in 2018, including financial services software firm SS&C Technologies' US$5.4bn acquisition of fellow software company DST Systems. When the deal was announced, SS&C CEO William Stone said the combination would help the firms cope with new regulatory and competitive pressures.

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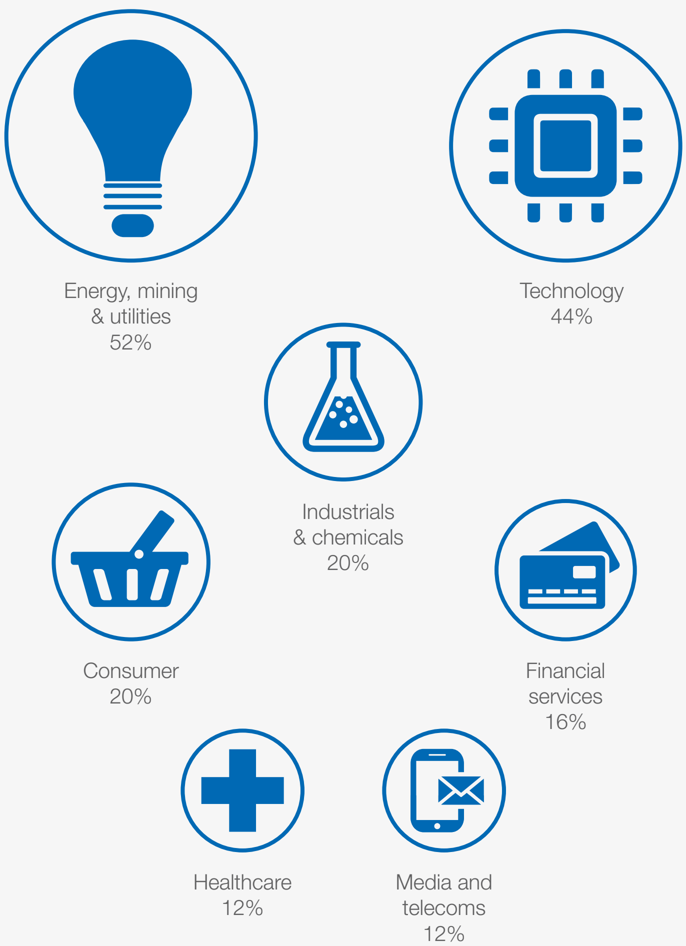

4 What percentage of megadeals will be cross-border in nature over the coming year? (Select one)

International deals have become commonplace in the modern M&A environment – especially when the transaction size is large. The percentage of megadeals that are cross-border in nature has held steady in the range of 42-52% over the last half-decade, compared to a range of just 33-35% for all M&A deals globally, according to Mergermarket data.

Indeed, companies that are able to afford massive acquisitions may be better positioned to take advantage of geographic expansion – or in greater

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Managing director at a New York-based investment bank

need of it to grow. For instance, Netherlands-based JAB Holdings acquired beverage maker Dr Pepper Snapple for US$23bn in January 2018, allowing the buyer to leverage Dr Pepper Snapple's massive US distribution network and stable of brands to improve JAB's existing food and beverage businesses, which include Krispy Kreme Doughnuts and Panera Bread.

In a different but also frequently-seen brand of megadeal, investment giant Brookfield Asset Management bought US nuclear energy company Westinghouse Electric for US$4.6bn in January 2018. The largest global asset managers such as Brookfield have become extremely active buyers of foreign businesses, since such deals can diversify their holdings geographically and allow them to put huge amounts of capital to work.

Over the next 12 months, nearly two-thirds of our survey respondents (64%) expect the cross-border megadeal trend of recent years to continue, predicting that 40-60% of megadeals will be international in nature. Sixteen percent believe 2018 will be an outlier year with more than 60% of megadeals being cross-border, and 20% predict the number of cross-border megadeals will be less than 40% of the total.

"The coming year will see an increase in cross-border megadeals – we are expecting a hike that will be above 40%, but it would be difficult to narrow that down to an exact figure," said a managing director at a US-based private equity firm. "Business has become more global in nature, and it is significantly easier to complete foreign deals above the US$4bn mark than it was in the past."

5 What will happen to the number of private equity-backed megadeals over the next 12 months?

Another major contributor to the return of the megadeal has been the revival of private equity-backed blockbusters. In 2017, there were 26 transactions valued at US$4bn or more by PE funds or PE-backed companies.

In a deal that made a major splash early this year, alternative asset manager Blackstone Group teamed up with Singaporean sovereign wealth fund GIC and the Canadian Pension Plan Investment Board to buy a 55% stake in the financial and risk unit of Thomson Reuters for US$17bn. The buyers saw strong growth potential in the business's data services and foreign exchange platforms, Bloomberg reported after the deal was announced.

This mega-buyout by a Blackstone-led consortium – which Mergermarket ranks as the fourth-largest PE buyout of the last 10 years – came after a year of headline-grabbing PE deals. These included two transactions led by experienced player Bain Capital: the US$10.6bn purchase of Toshiba's memory chip unit in September 2017 and the US$5.9bn acquisition of German pharmaceutical company STADA Arzneimittel after a bidding war in July 2017.

Our survey respondents largely believe the number of PE megadeals will rise further in the next 12

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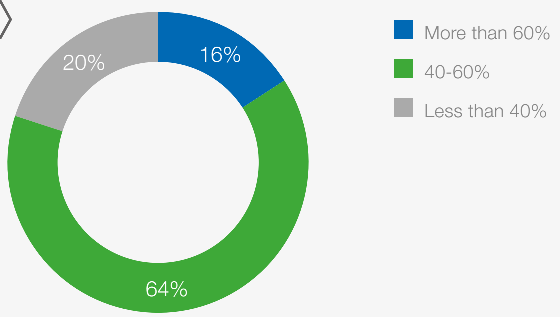

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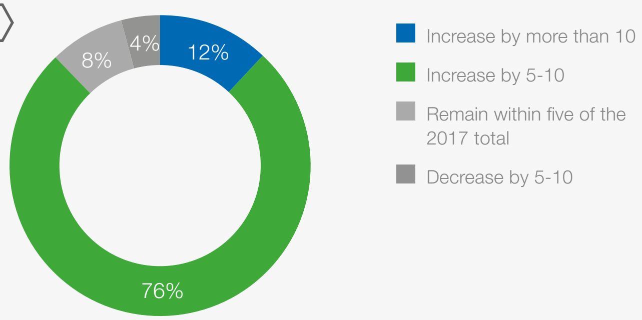

“It is significantly easier to complete foreign deals above the US$4bn mark than it was in the past. "

Managing director at a US-based private equity firm

months. More than three-quarters (76%) think there will be 5-10 more such deals than last year, while 12% foresee an increase of more than 10 mega-buyouts.

A New York-based investment banker predicts that the PE industry’s record fundraising levels will lead to more high-dollar acquisitions. In 2017, PE funds raised US$453bn globally, the most ever in a single year, according to Preqin. “This year will see an additional 5-10 megadeals made by private equity funds,” the investment banker said. “Some PE firms have the capital they need to complete deals above US$4bn rather easily. This year will again see them utilizing those funds and their expertise to make some big disruptive deals in the market.”

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6 **What will be the biggest barrier to megadeals over the coming 12 months?**

While there is strong momentum in favor of more large deals in the year ahead, barriers will prevent some transactions from reaching the finish line. After all, the risk of failure can rise substantially in megadeals, given the number of parties involved in the equation, from shareholders to regulators to other potential suitors for a target.

Two challenges that many megadeals face are often intertwined: excessively high valuations in the opinion of bidders and resistance from shareholders at targets. More than a third of our respondents (36%) believe high valuations will prevent large acquisitions from going through in the coming year and 24% think protests from shareholders will act as a top barrier as well.

Perhaps the highest-profile deal under discussion in early 2018 – Broadcom’s hostile bid for rival Qualcomm – has ostensibly been held up by these issues. In late February, Broadcom offered more than US$115bn for Qualcomm, but shareholders at the target balked, having already rejected a bid of more than US$120bn as too low. As of this publication, Broadcom had not moved to raise their offer, evidently convinced that they would be overpaying.

Another recent deal thwarted by high valuation demands and shareholder resistance was Emerson Electric’s multi-billion-dollar bid for industrial products maker Rockwell Automation. The latter rejected three increasingly lucrative offers from Emerson before the bidder stopped pursuing the deal in November 2017.

Antitrust risk remains a perennial threat to megadeals as well. The US$105bn tie-up between AT&T and Time Warner, for example, remains mired in regulatory approval processes after being originally announced in October 2016.

The director of M&A at an oil & gas company warned that valuations could spin out of control for certain large targets, preventing deals from getting done. “Valuations will be a concern for most of the businesses planning to enter a megadeal,” the M&A director said. “Although buyers will be prepared for slight increases, there will be targets that will demand valuations that are out of reach.”

7 **What will happen to the number of IPOs by US companies valued at US$4bn or more over the coming year?**

The environment for mega-cap companies to go public in the US remains uncertain despite a rebound in IPOs in 2017, due to tumult and high valuations in equity markets. Moreover, investors are cautious after poor showings by two of the most hyped debuts in 2017: those by Snap, whose share price fell more than 5% in a single day in late February after an episode of poor publicity, and meal kit company Blue Apron.

Nonetheless, the possibility of offerings by marquee names continues to fuel anticipation in the market. On February 23, cloud storage company Dropbox filed an S-1, announcing it would seek US$500m in an IPO to expand the reach of its subscription business, among other uses. The unicorn company had previously been valued at US$10bn, even though it is not profitable and had revenue of just US$1.11bn in 2017.

Fellow unicorns Lyft (US$11.5bn valuation) and WeWork (US$20bn valuation) are also reportedly considering IPOs in 2018. Meanwhile, Uber (US$68bn valuation) is aiming for a 2019 debut, and Airbnb (US$29.3bn) has put its IPO plans on hold after a management shakeup in early February 2018 left the company without a CFO.

Our survey participants broadly expect more IPOs by US companies valued at US$4bn or more in the next year, with 40% saying there will be 2-4 more such IPOs and 24% saying there will be an increase of five or more.

The current instability in stock prices will cause the pace of large IPOs to slow, according to the director of strategy and corporate development at a US-based communications company. “Mega-value IPOs will be a bit subdued,” he said. “There is still lot of volatility in the market.”

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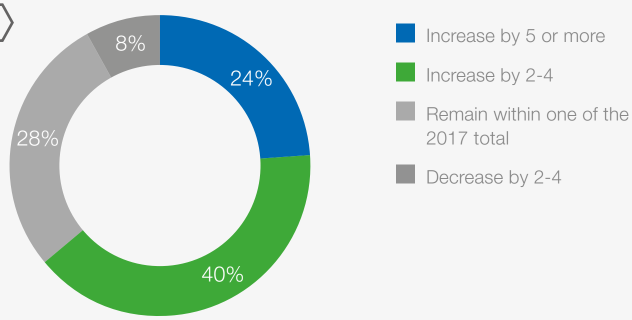

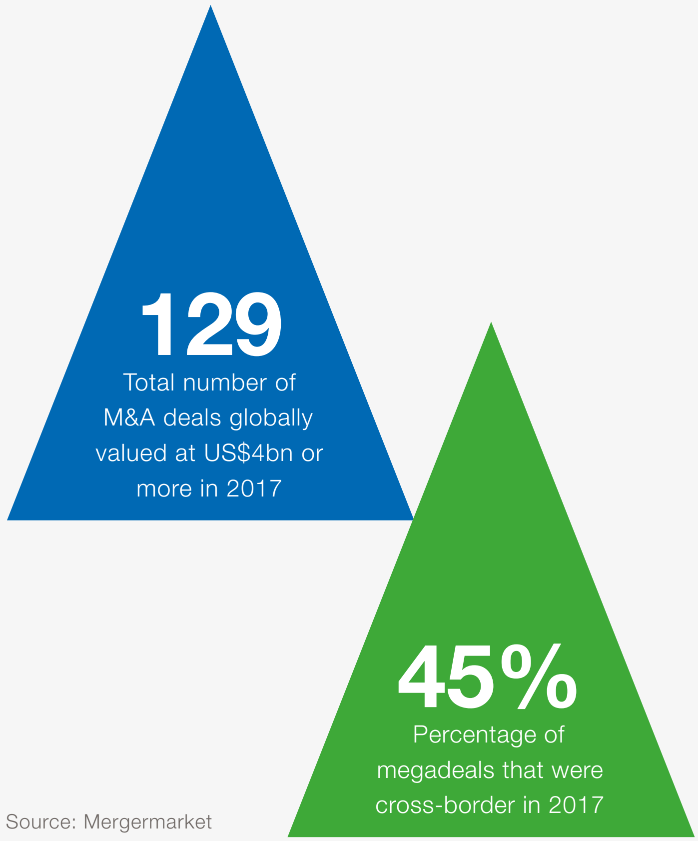

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