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M&A Insights

Q4 2019

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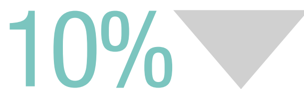
In an uncertain global environment, cross-border deals have reduced as investors turn their attention to domestic markets to do what are often big, strategic deals. Though deal value and volume are down, the market remains close to what are historic highs.

Decrease in global deal value
Q4 2019 vs. Q4 2018



Decrease in global deal volume
Q4 2019 vs. Q4 2018

Note: Figures represent deals announced between 1 January 2019 and 30 November 2019

Data provided by

01 *Megadeals and strategic domestic transactions take centre stage*

Deal value is down by 7% and deal volume is down by 10% in the year so far, but despite this evidence of growing caution among some investors, 2019 will still turn out to be the third strongest year in terms of value and the fourth strongest in transaction volume for a decade.

The fact that the market is still so strong when anxieties are rising around macroeconomic issues – particularly continuing trade tensions between the U.S. and China, the potential for conflict in the Middle East and, to some extent, Brexit – is proof that many investors are keeping their nerve.

That fact is underlined by a resurgence in strategic megadeals, which are once again powering the market. Deals over USD5 billion account for 43% of the value of worldwide M&A, while deals worth more than USD10bn account for 33% of total value. There's been a particularly strong surge in USD10bn-plus transactions, and it is remarkable to note that just 40 deals over USD10bn account for over USD1 trillion of value so far this year.

The other clear trend is the continued slowdown in cross-border deals – down by 27% – and the dominance of big domestic transactions, not just in the U.S. but globally, with the top 10 deals this year all homegrown within one country.

Most sectors, with the notable exceptions of life sciences and financial services, are feeling the pressure of these more uncertain times, and it is clear that many investors, notably PE funds, are expecting to see an adjustment in the market in the coming months, although not a sharp slowdown. Next year may well test nerves more sharply, but investors will, we believe, continue to be active, absent significant political or economic shocks.

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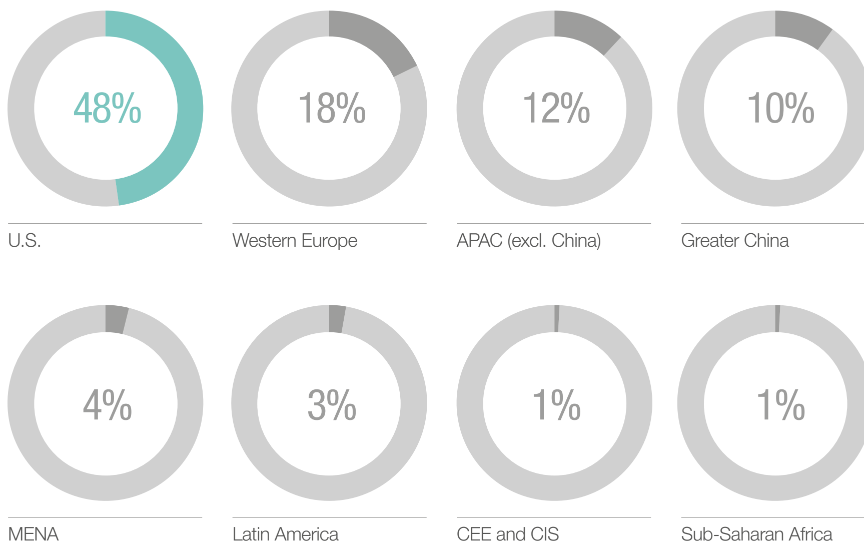
02 *U.S. continues to buttress the market – 2019 deal value by region*

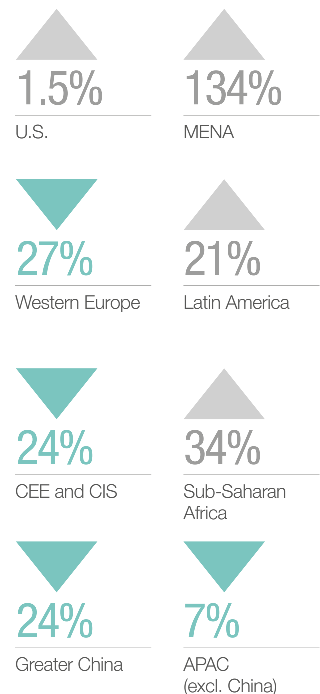
Accounting for around half of global M&A, the U.S. continues to drive transaction activity, even though the value has remained roughly flat in 2019 and the volume has fallen by 18%. While big domestic deals dominate, the U.S. remains both the biggest target market and acquirer in cross-border deals. By contrast, Europe and Asia, including Japan, are both down significantly. This year the European market is at its weakest since 2017, while Asia has not performed so poorly since 2014. Few regions are showing growth, with the exception of MENA, but a 134% rise in deal value here is largely down to one big deal (Saudi Aramco's merger with SABIC), and the underlying picture is much more mixed. Despite political upheaval, there are positive signs in Latin America, notably Brazil where cross-border investors are increasingly active.

THE STATISTICS

% split of global M&A deals by value

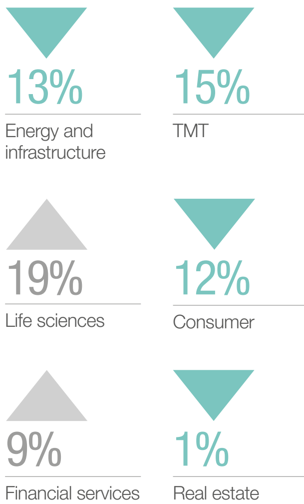


% change from Q4 2018

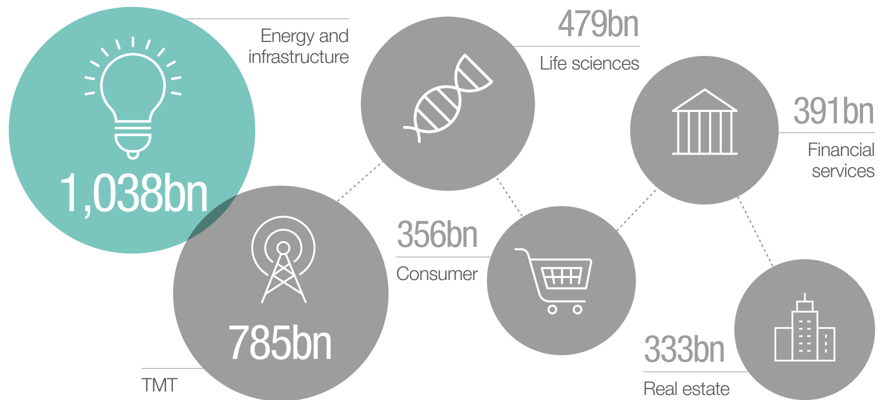


Note: Figures represent deals announced between 1 January 2019 and 30 November 2019

% change from Q4 2018



03 *Top six sectors by value (USD)*



Top life sciences and healthcare M&A deals in 2019

8 out of 10

over USD10bn

04 *Growth in more challenging times*

At a time of heightened regulatory and market uncertainty, it's perhaps surprising to see life sciences and healthcare sector M&A continuing to grow so strongly. Indeed, with deal value up by more than 19%, it was one of only two sectors to record growth in transaction value.

Not surprisingly, given the scale of the U.S. market, powerful R&D capabilities, private medicine and relatively lax price regulation, domestic deals have dominated, accounting for all but three of this year's top 10 global transactions in the sector.

Some have been highly strategic and have followed the trend of consolidation around key therapies, notably the giant Bristol Myers Squibb/Celgene merger combining two of the world's biggest oncology groups. Others have centred on the need to address a looming patent cliff, as we saw with the more opportunistic AbbVie/Allergan tie-up.

Pressures on M&A are coming from a number of angles – and in Europe, for example, German life sciences reforms, tighter controls on medical devices, privacy regulation and Brexit-related worries about research and supply ought to have unsettled the sector more than they have.

But issues specific to the life sciences sector – notably the patent threat from generics forcing pharma groups to invest in biotech, price pressures and a boom in medical technology – are pushing players to look for growth through acquisitions and collaborations. Chinese investors are also actively hunting across the globe, although substantially less so in the U.S. given ongoing trade tensions.

PE funds are increasingly interested in the sector, either in the medtech area or in niche pharma companies, which may be cash constrained but offer a valuable platform. And non-traditional tie-ups are proliferating elsewhere, with providers looking to team up with pharmacies, insurers or tech companies. Overall, that suggests that deal flows will continue to be strong in the months ahead as disruption continues.

Note: Figures represent deals announced between 1 January 2019 and 30 November 2019

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05 *Auto industry awaits full effects of disruption*

The USD40bn merger between Fiat Chrysler Automobiles (FCA) and Peugeot's owner, PSA, announced in October, comes at a time of escalating disruption in an industry that has remained remarkably stable for decades.

This is a sector that has seen many mergers and joint ventures over the years between its leading players, but one that has seen few real challengers emerge to threaten their market dominance. That's largely because few others have mastered the art of building internal combustion engines, a surprisingly complex technology.

With the advent of electric vehicles (EVs), that is likely to change radically, especially as battery technology improves. A whole range of potential competitors will be able to put this simpler technology to use, and, as data becomes the key to future mobility, rather than petrol, the field is increasingly open to tech companies and others to join the fray.

The industry giants are now reacting to this in two main ways. They are continuing to look for opportunities to achieve scale and global reach through consolidation, the rationale for the FCA/PSA tie-up.

Most have also set up incubators and tech accelerators to invest in tech companies that can help them compete in the new world of data-driven mobility services. Volvo Cars, for instance, has just announced investments in two Israeli start-ups, UVeye and MDGo. Toyota's USD1bn investment in the Asian ride-hailing business, Grab, is also part of this trend.

Their experience of mass-producing cars remains an advantage – there will still be demand for lots of vehicles. Tesla does not have such mass-manufacturing skills and its decision, announced in November, to site its new super factory outside Berlin, is, perhaps, a recognition that it can find the skilled autoworkers it needs more easily in Germany than in the new markets it wants to target.

While we may not see many more big tie-ups between the major players, there is still plenty of scope for consolidation among the companies that supply them. At the luxury end of the market, we may see growing alliances between makers of high-end cars and luxury goods manufacturers. Jaguar Land Rover is already the biggest exporter of luxury goods to Japan.

But we are certain to see a flood of investment and M&A activity as the industry becomes increasingly disrupted, and the ramifications will stretch way beyond the auto sector itself.

What will happen to the downstream operations of the oil companies, not least their petrol station networks? Car insurers will also have to rethink their model. As autonomous driving becomes a reality, and if, as expected, we move away from car ownership to subscription and leasing models, liabilities will shift from individual drivers to the vehicle makers and software providers, with huge cost implications that will need to be addressed.

"We are certain to see a flood of investment and M&A activity as the industry becomes increasingly disrupted."

06 *Waiting for price expectations to align*

In an overheated and uncertain market, PE investors are becoming noticeably more cautious in expectation of a market adjustment in the coming months, bringing buyer and seller price expectations closer into line.

A marked feature of 2019 has been the number of processes that failed to cross the line because sellers could not find buyers willing to pay rising multiples, which are commonly peaking at between 12 and 15x.

However, big deals do get done in this environment. PAI's acquisition of Armacell from Blackstone, Vista's acquisition of Accelya, from Warburg and KKR's sale of LGC Group to Cinven, Astorg and ADIA, are proof of that.

But investors are worried about the impact of macroeconomic issues on the underlying performance of target companies, and there is also a growing concern about increasing competition and valuations.

On the U.S. side, fundraising continues to be strong, particularly at the larger, more established funds, and may surpass 2018 totals. While multiples are creeping higher (hence the elevated level of fundraising in anticipation of multiples possibly cooling), unspent cash has surged and total deal value will likely be below 2018 levels. Exits are lower since the IPO market remains uncertain.

It's a pattern that repeats itself in European markets, which are increasingly tricky to read. Germany has seen some big deals – Bosch Packaging and ADCO, for example – which have attracted huge interest and gone through at breakneck speed – and Thyssenkrupp Elevator. At the same time, investors are holding off on other deals until they get a view of the economic outlook in 2020, although we are seeing a trend towards co-investment deals between PE funds and family owned "Mittelstand" companies.

Interest in P2P deals is growing, even though put up/shut up takeover rules in the UK are deterring some. But the failed Scout24 deal or the fight about OSRAM in Germany this year have left some feeling extremely wary, though many believe a successful DAX takeover is only a question of time.

Caution is also a watchword in Amsterdam due to various macro developments resulting in uncertainty among investors, although there is growing interest in this market from funds.

We do not expect the hiatus in dealmaking to last long and, unlike the years after the financial crisis, the correction this time will be buyer - rather than lender-controlled.

Funds have no intention of returning their huge amounts of accumulated dry powder to investors, but are waiting to put it to more innovative use, helped by the fact that investment deadlines are now more flexible than those of old.

"Private equity investors are becoming noticeably more cautious in expectation of a market adjustment in the coming months, bringing buyer and seller price expectations closer into line."

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“2020 may well test nerves more sharply, but investors will, we believe, continue to be active, absent political or economic shocks.”

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In focus: Consortium deals – a surer route to digital transformation?

Companies looking to harness the power of digital technology to transform industry processes or even entire markets are increasingly opting for consortium deals to spread the risks, the costs and, ultimately, the rewards.

Something is afoot in the world of trade finance. Traditionally a paper-based business, and long resistant to innovation, players all along the value chain have started to come together to explore platform-based solutions and new technologies like blockchain to drive greater efficiency and more transparency in their operations.

Some of the larger consortia currently active include we.trade, Marco Polo, Voltron, Forcefield, Komgo and VAKT.

These groups are each targeting slightly different aspects of the trade finance life cycle. we.trade, for example, aims to help SMEs manage, track and protect open account trade transactions, whereas Voltron is more focused on letters of credit. Meanwhile another recently announced example, Trado, is exploring a new supply chain finance structure in which blockchain and smart contracts are used to collect and record social and ecological data on suppliers.

And the trade finance industry is not the only one looking at consortia as a means of speeding up industry-wide uptake of new technologies. There is a growing number of organisations opting to set up consortium deals to bring about digital transformation.

Power in numbers

So why are consortium deals on the rise, particularly where developing highly innovative and market-changing technologies is concerned?

The simplest answer is that it is all about spreading risk and cost in an area which, by its nature, is highly experimental and requires significant investment.

Companies looking to accelerate digital transformation have one of three basic options – buy, build or collaborate. They can buy the technology and the people who have created it, invest (at potentially high cost) in building it themselves, or collaborate with partners that bring crucial technologies and skills to the table.

Traditional M&A and joint venture deals play a significant role in this process, but they can both carry high levels of risk in areas where innovative solutions are being explored for the first time. Indeed, if a technology is highly experimental or less developed, M&A buying could be one of the riskiest ways to go.

When looking for solutions that can disrupt entire marketplaces or sectors, many companies are now recognising that consortium deals offer the fastest and best way to bring about enduring change, while dispersing the risks involved among multiple players.

Only the very largest companies will have the market power or resources to bring about change by going it alone. Not only can such an approach be a heavy burden on an organisation but it also requires considerable confidence in the proposed product (often a challenge in untested or new technology).

For most, therefore, it is better to find a solution that has the backing of players right across the marketplace, bringing together people with a common vested interest in creating a successful solution and who, together, can validate it in the wider marketplace, speeding up the process of adoption.

Complexity of the unknown

Most consortia are structured as a distinct private limited company. Shares will be issued in return for what is often a relatively small initial investment and with the rights of individual investors carefully and equally protected. Usually, it will be important that no one player is perceived to be in the driving seat or likely to benefit most.

But creating such shared structures to bring a market-changing technology to life is fraught with complexity.

First, there is the issue of trying to balance a wide range of potentially conflicting interests. For example, one company – already working on a system that tries to address the issue at hand – may be concerned that its own business will be cannibalised by the new technology.

Trickier still is handling the complexity of the unknown. Since the technology may only be at the very earliest stages of conception, how do you legislate for what might happen three or four years down the line when you don't yet know what the system can or should do? This degree of uncertainty is in clear contrast to many conventional joint ventures, where a project usually will have a defined objective and the parties, often with different levels of interest in the venture,

"Consortium deals are an increasingly important weapon in the armoury of companies looking to use technology to disrupt outdated and inefficient marketplaces, alongside traditional M&A and joint venturing. There is every reason to believe we will see deals, increasingly innovative in their structure, multiply."

will have a pretty clear idea of when and how they will exit.

Where consortium deals are concerned, it is important to create bodies within the consortium's governance structure that are charged with not only managing the immediate challenges of the company but also to think ahead to what new rules or support might be needed by the consortium as the project develops. Adaptability is the key.

The corporate structure also needs to remain flexible to take account not just of changes in the market but changes in ownership over time. A total lock-up of the parties' interests is often counterproductive and thought should be given as to how ownership may need to change as time goes by. Some investors may want to build their stake but, equally, some may want to exit early, while others may want to join as the platform builds momentum and is able to attract greater interest in the market. The terms for each need to be clear from the off so that the parties know the rules by which they hold their investment. As the need for funding increases, the consortium may want to seek additional investment or to stage an IPO to raise necessary finance. These issues should be carefully taken into account from the outset.

Careful structuring is also important to protect intellectual property and the goodwill flowing from it. Investors will want to be sure they are investing in a clearly defined structure where the IP is locked up in the entity, for the benefit of the company as a whole as well as the individual parties.

As with any tech-driven business, a clear understanding of treatment, protection and monetisation of data will also be a point to consider from the outset.

Overall, the process of building a successful consortium is painstaking work. It is not unlike designing a constitution for a country or a society, a system of governance that anticipates change in the future and can stand the test of time.

More deals to come?

It is already clear that consortium deals are an increasingly important weapon in the armoury of companies looking to use technology to disrupt outdated and inefficient marketplaces, alongside traditional M&A and joint venturing.

We have already seen them deployed in a range of settings, including huge infrastructure projects, such as pipeline building, and in pharmaceuticals, often with a crossover between the public and private sectors.

As digital technology disrupts more and more sectors there is every reason to believe we will see deals, increasingly innovative in their structure, multiply and we might even expect some consolidation between existing consortia.

With the stakes so high, consortium deals not only provide a way to spread risk among multiple stakeholders with a common interest, but increase the chances of new technologies being validated and adopted right across the supply chain – ensuring that effective and lasting digital transformation can take place.

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Consortium deals – some key considerations

Consortium deals offer an effective way to speed digital transformation, but require very precise planning and execution. Here are some of the issues that will require careful thought:

Scope and purpose – investors must agree on the objectives of the collaboration, backed by a clear business plan and early identification of any red lines for participants. This often means a more lengthy term sheet negotiation so that parties are as clear as possible on what is being built. Close participation between the legal and business teams in helping to identify potential issues often yields a more informed and robust structure.

Ownership and financing – care should be taken in considering the rules by which investors may hold and transfer their interests in the consortium and the process by which the consortium raises additional funds or welcomes new stakeholders. There are many important issues to consider; from whether a lock-up is appropriate (eg when the business is preparing to launch its product), to change-of-control mechanics, to what, if any, veto participants have on raising debt or new investors joining the consortium.

Expertise and governance – it takes time to attract the right members who fully represent the marketplace and have an appropriate spread of skills, but is vital. Governance issues such as voting and veto rights and selecting the right management team (as well as how to incentivise that team) require detailed consideration from early days and must be kept under review. Developing an appropriate committee system to help nurture the young business and draw the best from the consortium members is also an important consideration.

IP – loss of background IP rights is often one of the main concerns of organisations joining a consortium and, in general, IP risk issues are more complex in this sort of collaboration than those in a traditional strategic investment or M&A. Issues need to be carefully covered off by clearly defined agreements at the pre-contract and formation stages, during the life of the deal and potentially on termination.

Data – data is increasingly recognised as a valuable asset of any collaboration. Frequently, it is addressed as an asset class as part of the commercial agreement, alongside intellectual property rights and other assets.

Regulation – the level of regulation that the consortium will attract will be driven by its proposed products, the markets in which it operates and the share of those markets it captures over time. It is a point that needs to be considered not only at the planning stage but throughout the life of the consortium.

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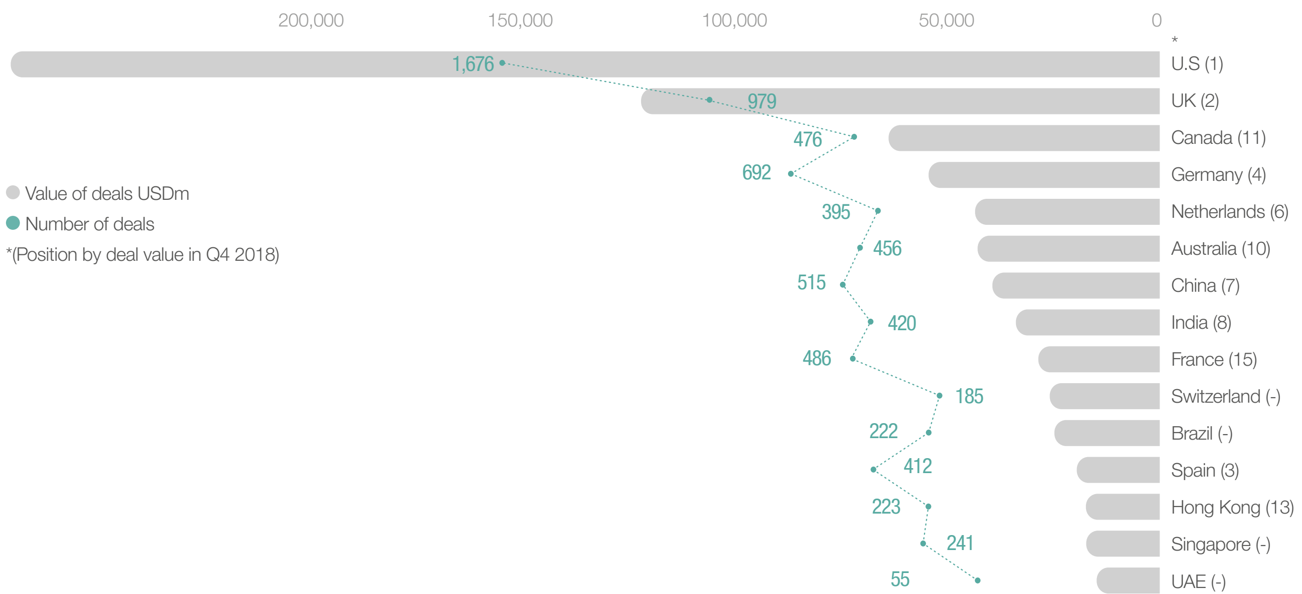
Global deal flows

Inbound target markets



01 *Consolidation continues to drive MENA M&A activity*

A single deal – the USD69bn acquisition of SABIC by Saudi Aramco – took centre stage during an extraordinary 134% increase in deal values in the MENA region.

But while the effect was a one-off and masked more moderate underlying activity, it nevertheless points to an important trend, as does Aramco's upcoming and much-awaited IPO.

Governments are stepping up their efforts to monetise their investments to fund a diversification away from the region's deep dependence on oil and gas revenues. The USD4bn investment by KKR and BlackRock in a 40% stake in the Abu Dhabi National Oil Company's pipeline business falls into this same category, just as ADNOC Distribution's IPO did in 2017 (at the time the largest for ten years in the region).

Separately, there is a continued emphasis on consolidating assets, owned or controlled by common government agencies but operating independently, particularly in the FIG sector as we saw with the near USD4bn merger of Abu Dhabi Commercial Bank and Union National Bank.

The drive to attract foreign investment to the region continues, with tech companies particularly to the fore. Uber's USD3.1bn acquisition of Careem, the Dubai-based ride-hailing business that operates across 15 Middle Eastern markets, is a case in point.

There is also a continuing interest in attracting socially vital investment, notably in the education and healthcare space. An example is the recent acquisition by a consortium led by funds advised by CVC Capital Partners of a significant minority stake in GEMS Education, the world's largest provider of private K-12 education services.

Despite the continued security and political tensions in the region, investors remain cautiously optimistic about the outlook.

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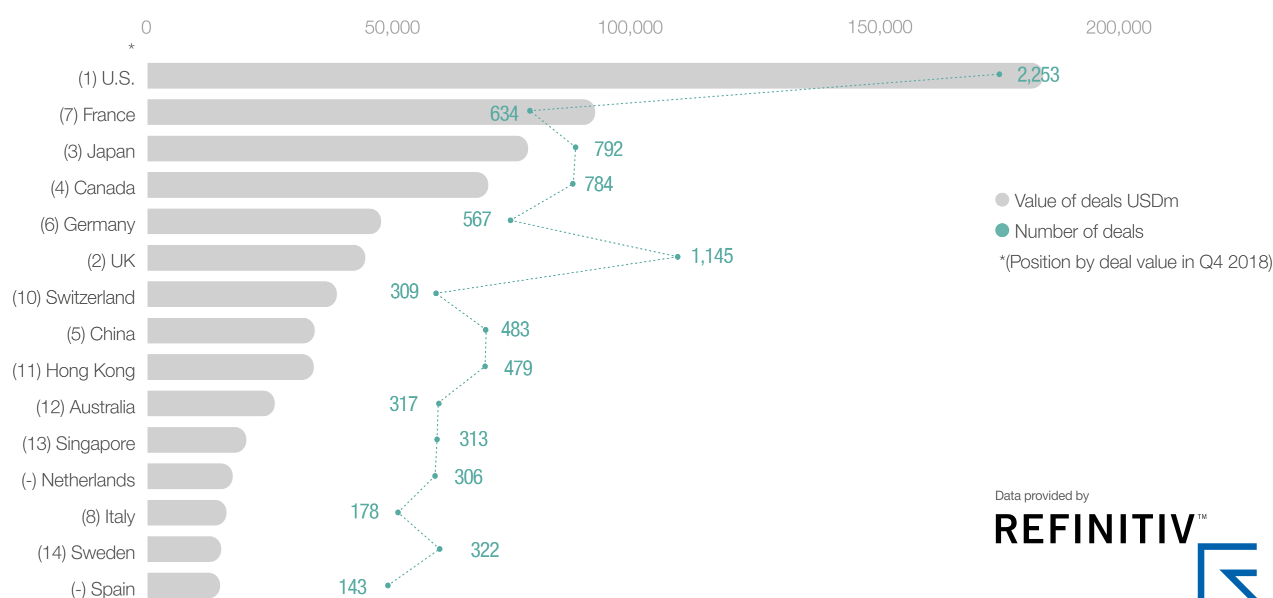
Outbound acquirers



02 *Brazil targets inbound investors with privatisation plan*

At a time of declining global cross-border activity, Brazil is bucking the trend, rising to eleventh in the league of top target markets for inbound investment and for several reasons.

The devaluation of the Real means assets are increasingly attractive to foreign investors, while the lowering of interest rates to 4.5% as of December 2019, is helping local banks to finance deals on attractive terms.

A huge programme of proposed privatisations is in the pipeline, drawing interest from a range of international investors, including corporates, PE, infrastructure, pension and sovereign wealth funds.

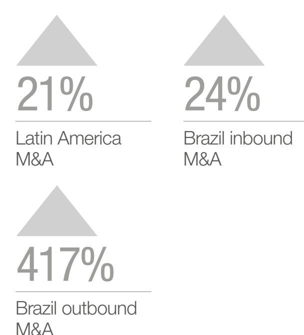
At the federal level, over 100 companies are lined up for sale, while, within key states such as São Paulo and Minas Gerais, power distribution, mining, toll roads, and water and sanitation companies could also be on the slate.

The sell-off process has been boosted by a Supreme Court decision in June allowing state companies to dispose of subsidiaries without Congressional approval.

On top of that, BNDES, the national development bank, is selling up to 80% of its assets worth USD29bn, and Petrobras, the oil giant, continues to divest through direct disposals or capital market issues.

The Bolsonaro government remains controversial and Brazilian politics continues to be rather volatile. But investors appear confident that deregulation and the market-friendly policies it is implementing will continue to yield opportunities and further increase foreign direct investment before the next round of presidential elections in 2022.

% changes in regional values



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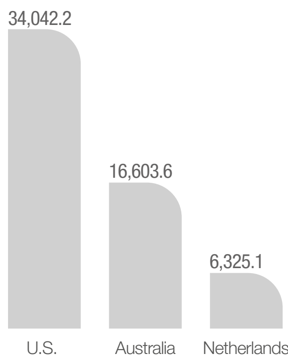
03 *Japan's outbound drive continues apace*

Japan's top three outbound M&A destinations in 2019 (value USDm)



Japanese companies are continuing their search for assets across the world, with Japan the third most active acquirer nation, investing over twice as much abroad as China in value terms.

That trend continued in Q4 with a number of sizeable deals, including Asahi's USD11bn acquisition of Carlton & United Breweries from AB InBev, the largest ever Japanese investment in Australia. We expect this outbound trend to continue.

The main factor driving activity is demographics. With an ageing population, the domestic market is shrinking and businesses recognise that the best way to achieve top-line revenue growth is through M&A.

Deals are often funded using the acquirer's balance sheet. Shareholders also tend to be fairly modest in their demands for immediate returns. Domestic debt also remains abundant, and Japanese banks are looking for opportunities to deploy their resources.

Investors currently tend to be favouring more established markets, with on average around 40% of capital flowing into North America, 30% into Europe, 25% split equally between ASEAN markets and China, and the remainder going to the rest of the world.

The UK has been negatively impacted by the uncertainty surrounding Brexit, but remains an attractive target if the business being acquired has a strong domestic market, as we saw with MS&AD's investment in Swiss Re's UK closed book life business. But due to Brexit, the UK is no longer regarded as a bridgehead into the EU and many Japanese companies have relocated their European headquarters to the Continent.

Investment into Japan is also buoyant right now helped by the spotlight thrown on the country by the Rugby World Cup and the Olympics. Investors are looking to acquire less passive investments than in the past. Operating companies and infrastructure assets are now in the frame, whereas assets such as real estate, requiring little management, were preferred in the past.

Meanwhile the domestic M&A scene is also more active. Japanese conglomerates have become more strategic than was traditionally the case, and are looking to dispose of non-core businesses or to consolidate, as we have seen with Hitachi's decision to divest Hitachi Kokusai and Hitachi Chemical and combine its auto business with Honda's three leading suppliers.

Note: Figures represent deals announced between 1 January 2019 and 30 November 2019

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