

PwC Deals year-end review and 2018 outlook

Getting ahead as disruption accelerates

We entered 2017 with a new US presidential administration and plenty of questions about how policy changes would affect deal activity. While the administration's influence over the economy remains unclear going into 2018, it hasn't hampered the need of some companies to fuel inorganic growth through deals.

This is merely one disruption that dealmakers are navigating as the new year approaches. Technology has long been disruptive, but never has it been so pervasive, infiltrating virtually all corners of business. Emerging technologies such as artificial intelligence will not only upend how we do business but also change the way we work, particularly as the population ages and traditional ideas of the workforce evolve – all of which could affect how potential acquisitions are evaluated.

Globalization continues to impact US deals as developing countries have emerged as consistent investors in their own right. The Middle East, China, India and other parts of Asia have advanced to become bigger players in deals as economic reforms and other efforts attract foreign investors.

Within this environment, the volume of M&A in the US and across borders was up in 2017. While deal values are down – driven largely by a decline in megadeals – a spate of large-scale takeovers in the works suggests that things may be about to change.

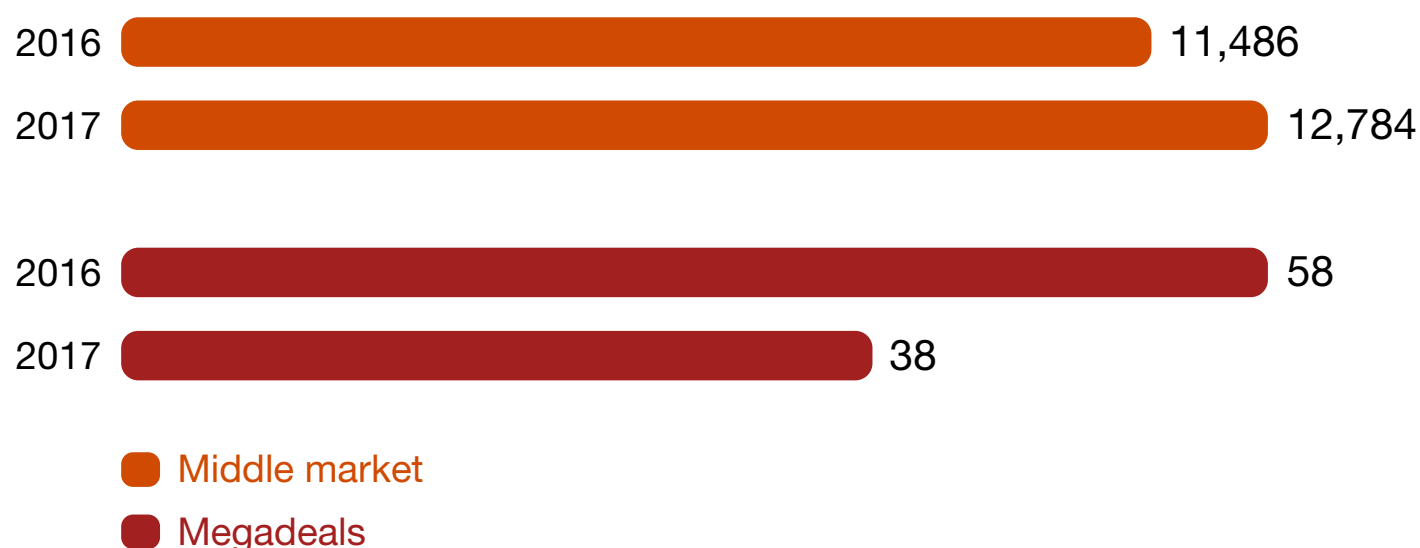
Looking back: Buyers saw fewer targets as valuations soared

For most of 2017, the M&A picture was mixed: In the US, buyers continued acting on historically low borrowing costs and a strengthening economy. The stock market has hit record highs, while at the same time the November unemployment rate remained at its lowest since 2000¹. As the economy gathered momentum, the market became too expensive for many buyers, who thought twice about making major moves in the face of rising valuations for potential acquisitions.

Abroad, parts of Europe and Asia drove inbound and outbound investment, while the Asia-Pacific led the way in new stock listings. The region surpassed the US to become the dominant IPO region, as many US companies flush with private capital demonstrated little urgency to go public. Of the more than 1,450 IPOs so far this year, roughly two-thirds originated from the Asia-Pacific, helping put 2017 on track to become the busiest year for new listings through 2007².

Middle market vs. megadeals

Deal volumes



Data for each year reflects Jan. 1 to Nov. 15.
Middle market deals rose as megadeals declined in 2017.

Source: Thomson Reuters with PwC analysis.
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1. CNNMoney.com, [Another strong jobs report](#), Dec. 8, 2017

2. The Wall Street Journal, [IPOs roar back world-wide, with Asia driving the boom](#), Nov. 13, 2017

Looking ahead: Megadeals poised for a comeback

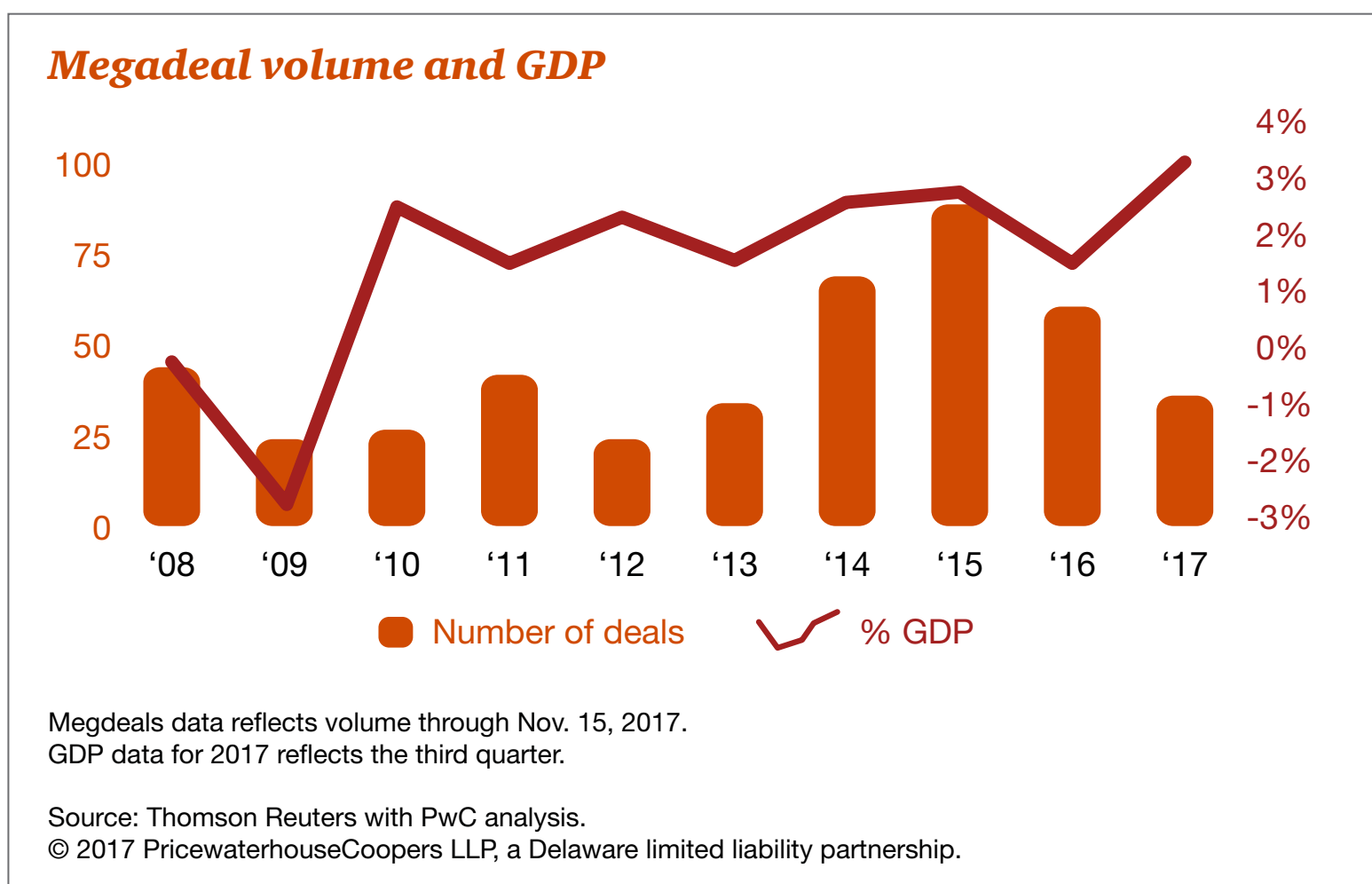
Recently, M&A values have picked up significantly, with a record dollar amount in deals announced in November³. That could herald a comeback for deal values and megadeals – those worth more than \$5 billion – in the year ahead.

The long-awaited tax overhaul bill could potentially inject companies with extra capital that would be available for deals, if not returned to shareholders. It also would give investors more clarity in an uncertain regulatory environment. But that sigh of relief may be short-lived, as Washington may turn its attention to trade and antitrust policies.

Riding populist sentiment, the US this year pulled out of one of the biggest global trade deals, the Trans-Pacific Partnership, and is re-evaluating the terms of a more than two-decades-old trade agreement, NAFTA. Nonetheless, companies planning for long-term growth are powering through this uncertain regulatory environment, even if some deals could raise new kinds of antitrust issues.

Whereas the last M&A boom in 2015 largely included deals between direct competitors trying to gain scale and cut costs, the landscape for megadeals in 2018 could look far different. Some companies are trying to remain competitive as new players – particularly tech giants – move into their industries.

The need to adapt has rippled into recent deals that are either under discussion or awaiting approval. Take CVS Health Corp’s roughly \$69 billion bid of Aetna Inc., Walt Disney Co.’s interest in 21st Century Fox Inc.’s assets, Broadcom’s \$105 billion bid for Qualcomm and AT&T Inc.’s planned purchase of Time Warner Inc. These say a lot about not only the types of deals to come but their scale as “gigadeals”⁴. Many will be watching the government’s response, particularly as AT&T prepares to go to court after the US Justice Department blocked its approximately \$85 billion bid for Time Warner.



3. The Wall Street Journal, [Takeovers roar to life as companies hear footsteps from tech giants](#), Nov. 20, 2017

4. PwC’s Deals Blog, [The new corporate M&A environment: Uncertain, unfazed and uncharted](#), Oct. 18, 2017

America's conglomerates: A bellwether for big deals

The volume of divestitures is up 4% so far this year and on pace to be the highest in more than a decade. This likely will rise further if the pace of transformation of US conglomerates is any indicator. For the past few years, companies including GE⁵, Pfizer⁶ and Procter & Gamble⁷ have moved to refocus their businesses by exploring the possibility of shedding assets.

These transformations could be accelerated by the growing influence of activist shareholders. Earlier this year, Trian Partners won a seat on GE's board⁸ while continuing to campaign for a seat on P&G's board⁹. The reduction in the corporate tax rate contemplated in the proposed tax reform legislation would lighten the tax burden of selling some of these assets, further spurring deals activity.

However companies decide to divest, those transactions would help address the supply of deals, a much-needed development at this point in the M&A cycle. Many companies and PE firms have the desire and the capital to make deals today, but a lack of appropriate targets at acceptable values has led them to hold onto their cash.

Divestitures up in 2017

2016

3,133

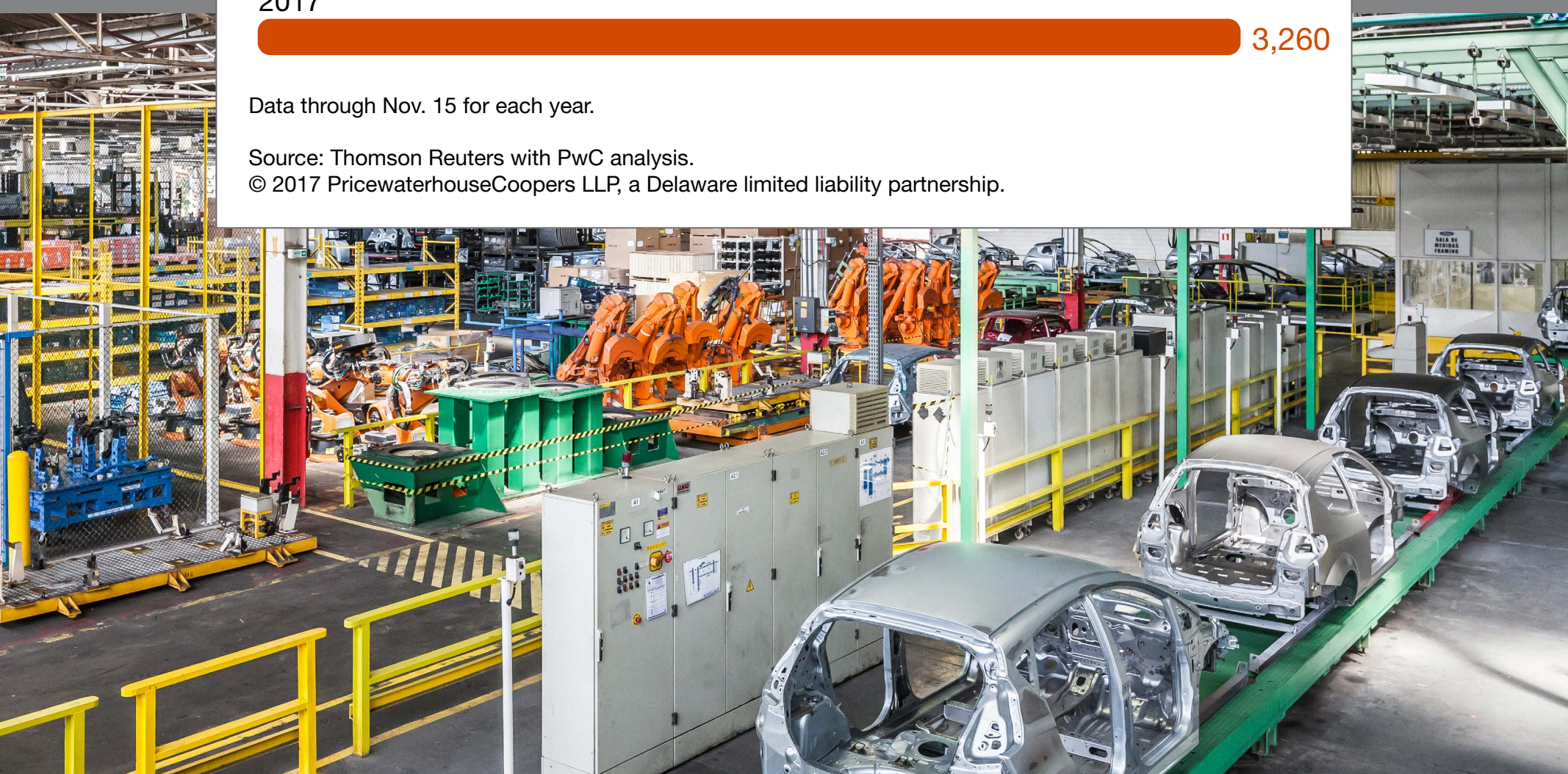
2017

3,260

Data through Nov. 15 for each year.

Source: Thomson Reuters with PwC analysis.

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5. Reuters, [GE explores divesting its transportation, healthcare IT businesses](#), Oct. 26, 2017

6. Reuters, [Pfizer to launch consumer health sale in November](#), Oct. 25, 2017

7. USA Today, [Procter & Gamble prepares to split off 41 beauty brands](#), Sept. 27, 2017

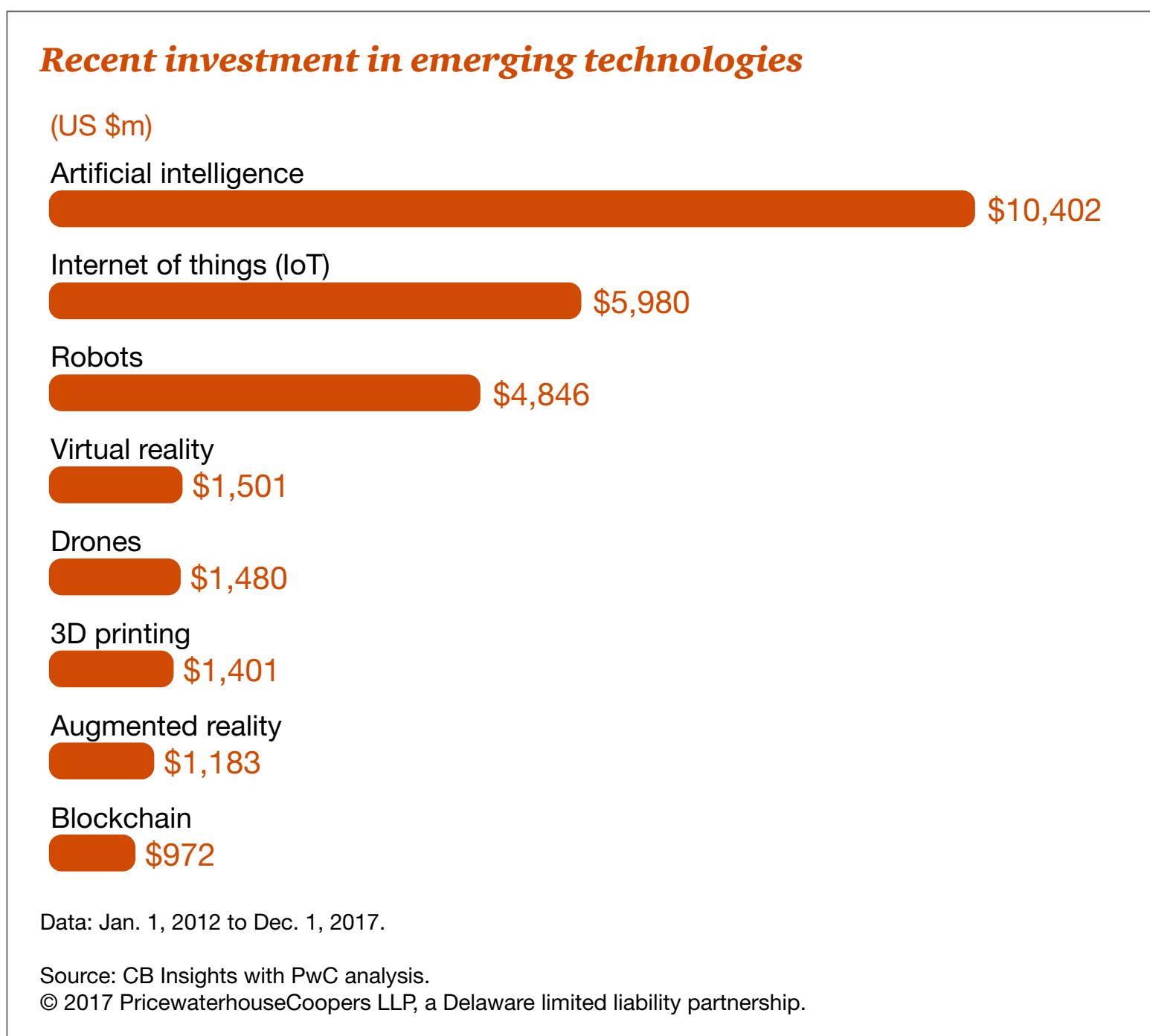
8. The Wall Street Journal, [GE Gives Activist Trian a Seat on the Board](#), Oct. 9, 2017

9. The Wall Street Journal, [Activist Peltz narrowly wins P&G board seat, new count shows](#), Nov. 15, 2017

From startup to M&A target: AI as the next driver?

Emerging technologies is another area to watch in 2018. In recent years, investors have poured capital into technologies that have yet to go mainstream, but not all have advanced much beyond backing from venture capitalists. Since 2012, investors have invested more in AI than any other emerging technology, including IoT, augmented reality and 3D printing, according to a PwC analysis of CB Insights data.

This suggests that in the coming years, AI could lead the way in deals, given that nearly half, 47%, of all AI companies acquired since 2012 have had VC backing¹⁰. Already, tech companies like Google, Yahoo, Intel, Apple and Salesforce are competing to acquire private AI companies. Ford, Samsung, GE and Uber are also investing in this space, and the list will likely grow. Consider that since 2012, more than 250 private companies using AI algorithms across different verticals have been acquired, including 37 acquisitions alone at the start of this year¹¹.



10. CB Insights Research Briefs, [The race for AI: Google, Baidu, Intel, Apple in a rush to grab Artificial Intelligence startups](#), July 21, 2017

11. CB Insights Research Briefs, [The race for AI: Google, Baidu, Intel, Apple in a rush to grab Artificial Intelligence startups](#), July 21, 2017

Cross-border deals: Europe's comeback amid populism

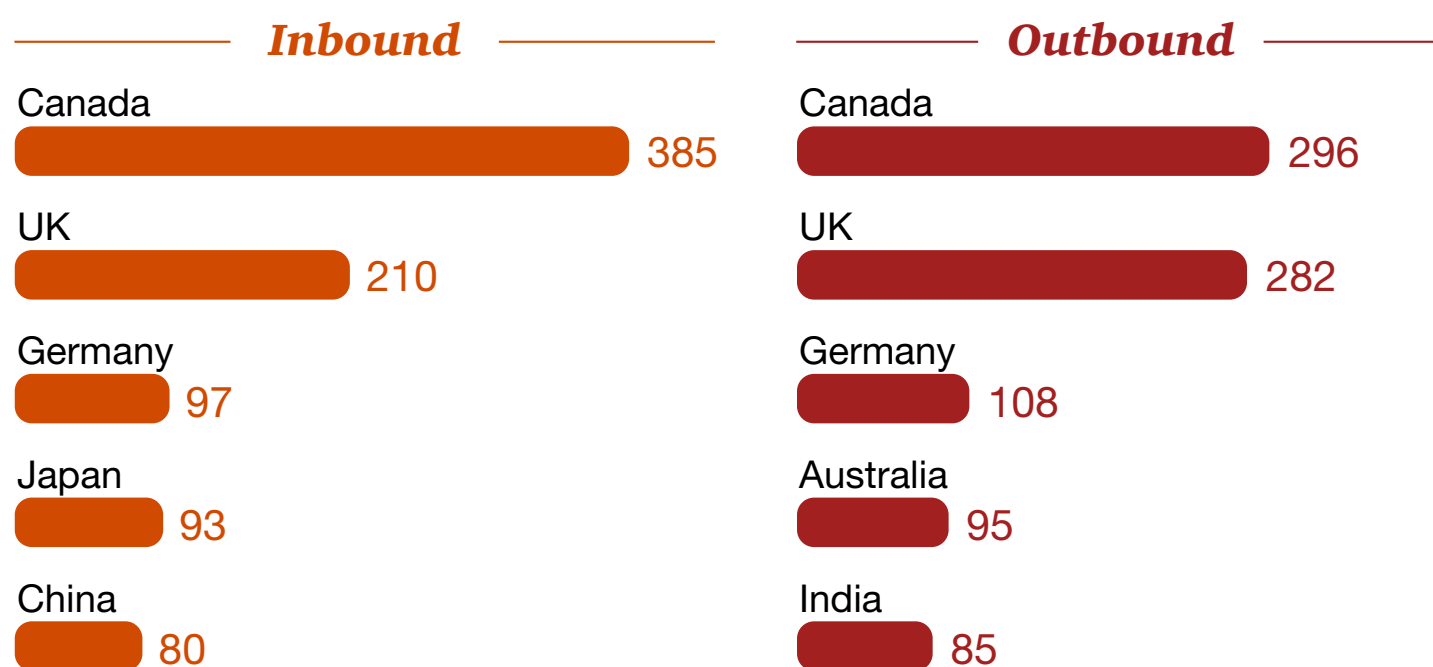
Even though the shock of Brexit and the US presidential election lingered through the start of 2017, it didn't discourage investors at home and abroad as the Eurozone economy rebounded in big ways. After Canada, the UK and Germany, respectively, led the way in both US outbound and inbound investment through November.

This doesn't mean that populism has softened; if anything, it's likely to continue rising, as European nations consider tighter restrictions over foreign investment and mass migration. The turnaround coincides with the political sentiment for creating European champions to counter US and Chinese economic influence. The bloc's recovery from its sovereign debt crisis is still fragile, particularly Britain's economy as its EU departure looms. But the Eurozone is closing 2017 with unemployment at its lowest in almost eight years and economic growth back to levels not seen since 2011¹². This comes as France's new president, Emmanuel Macron, has settled into office and publicly championed the EU.

Eastern Europe has benefited from the brighter outlook. Unemployment rates in Poland, the Czech Republic and Romania are at all-time lows and well below the European average¹³. The momentum will likely continue if the Eurozone continues to grow, as almost two-thirds of the value of Eastern Europe's exports goes to the EU¹⁴.

As economic reforms play out, including measures to improve France and Spain's labor markets, growth could accelerate and help drive M&A next year. The recent increased interest by activist investors in European companies also could be a factor¹⁵.

US cross-border deal volumes



Data: Through Nov. 15, 2017

Source: Thomson Reuters with PwC analysis.

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12. The Telegraph, [Eurozone unemployment lowest since 2009 as GDP growth remains robust](#), Oct. 31, 2017

13. The Financial Times, [Exports and low unemployment fuel rapid growth in central Europe](#), Aug. 16, 2017

14. The Financial Times, [Central and Eastern Europe show way of growth](#), June 14, 2017

15. The New York Times, [With crowding in US market, activist investors look to Europe](#), June 26, 2017

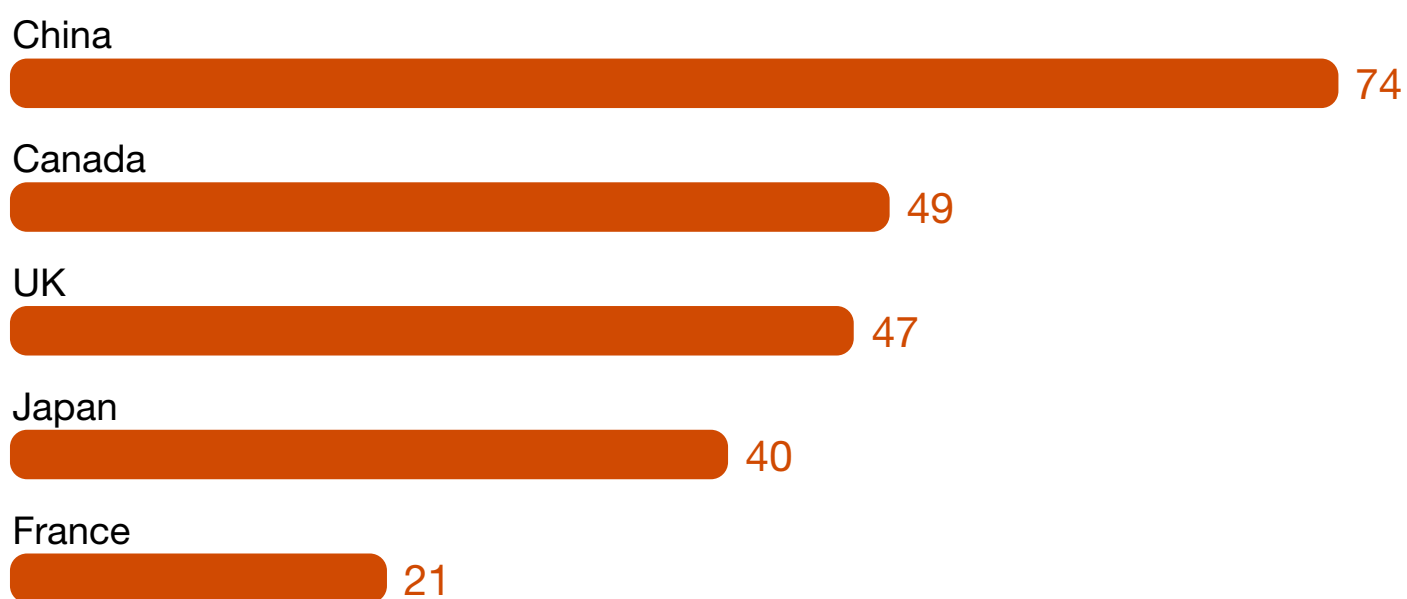
Cross-border deals: China as a wild card

After a record year in 2016, the pace of outbound mergers and acquisitions by Chinese firms slowed significantly as China's government grew concerned that too much money was leaving the country. Officials limited investments in certain industries, including sports and hotels, which left investors holding off on deals as the rules became less clear.

Those uncertainties have eased following October's Communist Party gathering in which President Xi Jinping underscored the need to continue pursuing economic reforms and did not announce new restrictions over foreign investments. This signals that China could see an acceleration of deals, and its push for infrastructure investment will likely be a key driver. Moreover, the country plans to remove foreign ownership limits on banks, giving global financial companies unprecedented access to the economy.

But as China opens its doors, the US has tightened its borders. Earlier this year, the Trump administration blocked a Chinese-backed investor from acquiring a US semiconductor maker following concerns from the Committee on Foreign Investment in the United States (CFIUS) that the deal posed national security risks¹⁶. The president's move was rare but not surprising in the sense that the US has been serious about protecting America's high-tech industry. Lawmakers have proposed a bill calling for stiffer CFIUS reviews; whether Congress approves the legislation, CFIUS will almost certainly weigh more heavily on Chinese investors newer to the US market.

Top five countries for CFIUS reviews, 2013-15



Source: 2017 CFIUS Annual Report to Congress
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16. PwC's Deals Blog, [New Deal Frontier: Road bump or full stop? What the blocked Lattice acquisition means for other China-US deals](#), Sept. 22, 2017

What to expect in 2018

After the decline in megadeals in 2017, investors are likely to enter 2018 with deal values rebounding. Companies are strategizing to thwart competition from tech giants at a time when activist investors gain unprecedented influence over US business. But as companies scale down and leverage growing markets, tech firms are steps ahead, pouring investments into AI and other emerging technologies amid a cash-rich US economy.

The availability of capital has been fueled by near-record private equity fundraising, historically low interest rates and the potential that US lawmakers could repatriate overseas cash back to the US through legislation now being discussed in Congress. And Europe and China also are poised to drive deals, as ongoing economic reforms improve the prospects of investment in these regions.

Companies and investors will need to continue adapting to these influences. An abundance of capital alone may not conquer high valuations, especially amid evolving technology, shifting demographics, political uncertainty and other disruptors. Acquisitions, alliances and other transactions will happen, but success comes not in making a deal, but making the right deal.

Let's talk

The following PwC professionals contributed their experience and knowledge to produce this paper. For a deeper discussion on deal strategy and trends, please contact one of our leaders:

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