PitchBook

North American M&A Report

3Q 2019

PitchBook

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A note on methodology: In previous reports, our data has only included estimates from the current quarter. Beginning in this edition, we will include estimates for value and count going back four quarters to include a full year's worth of estimates.

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Introduction

North American M&A activity continues apace. Numbers through 3Q 2019 indicate that we are progressing toward another $2 trillion-plus year, with the media sector playing an outsized role recently. However, economic uncertainty is affecting the overall market and fewer massive deals were announced in 3Q than in prior quarters. The US/China trade war rages on and has led to a precipitous decline in cross-border activity, with far fewer Chinese companies willing or able to acquire US companies. Without a firm resolution to the dispute, M&A activity between these two economic powerhouses may wane going forward.

Multiples and deal sizes remain elevated. M&A transactions continue to close at double-digit EV/EBITDA multiples as companies bid up prices. Headline prices are rising as well, with companies pursuing heftier acquisitions that will move the needle. Technology is playing an outsized role in that trend, especially as acquirers target high-growth companies, many of which are still VC-backed. With tens of billions of dollars pouring back into the VC ecosystem, startup volume continues to climb, and these companies will keep making up a growing proportion of M&A targets.

North American M&A activity in the financial services sector continues to proliferate. Insurance has been a popular sector as PE firms use premiums as a source of permanent capital. The face of banking is changing in the wake of the user migration to technological disrupters with increased mobile and internet accessibility. This has led to a continuation of the long-standing trend of bank consolidation as smaller regional and national banks attempt to scale.

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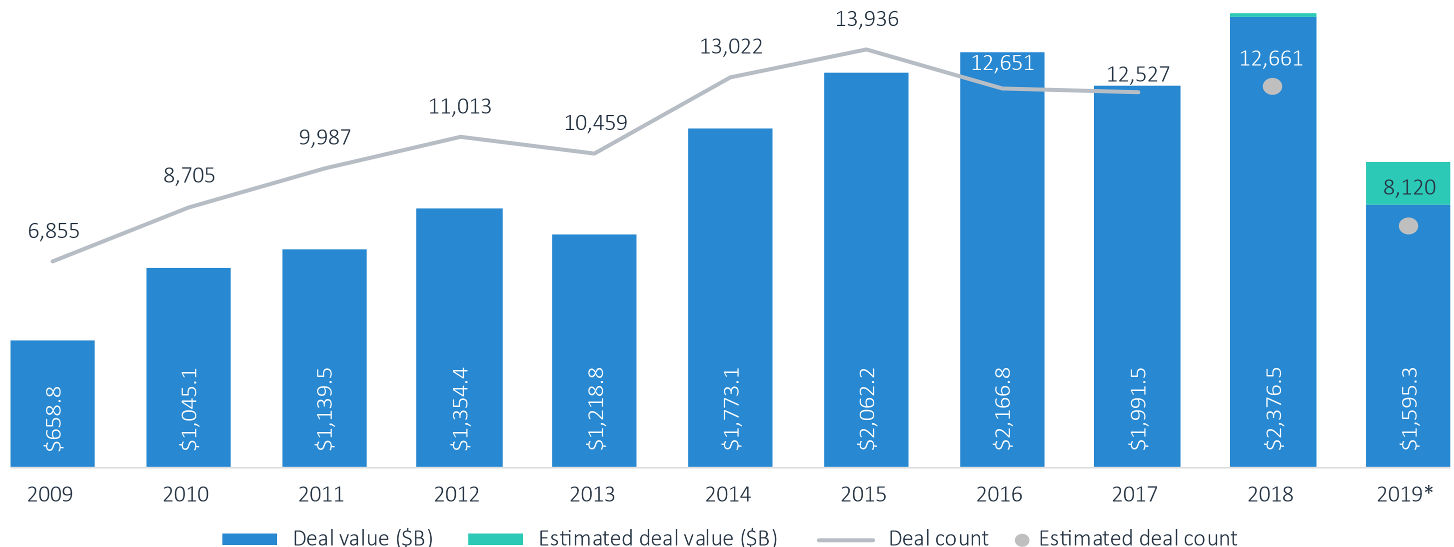
Overview

M&A activity



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

In 3Q 2019, North American M&A activity saw another quarter with robust deal flow, totaling over $600 billion. In 2019 to date, we have seen over 8,000 deals close with an accumulative value of nearly $1.6 trillion, approximately on pace with the first three quarters of 2018. Much of this quarter's total value was attributed to just a few colossal deals. In fact, eight deals above $10 billion closed during the quarter, accounting for over one-third of total deal value. Additionally, with announced deals such as Bristol-Myers Squibb's (NYSE: BMY) $74.0 billion acquisition of Celgene and BB&T's (NYSE: BBT) $66.0 billion acquisition of SunTrust Bank likely to close in 4Q 2019, we expect M&A value to end the year on a high note, barring any broader economic slowdown.

The talk of an economic shock, whether it be as a result of the trade war with China or political unrest in the Middle East, has permeated the financial news. If such an economic recession occurs, it could dramatically lower M&A activity for years to come. We have seen two particular economic omens in recent months: the two-year and 10-year rates inverting in the US and the Federal Reserve cutting short-term interest rates for the second time this year. Despite these indicators, the S&P 500 is roaring and up nearly 20% through 2Q 2019, though it has been relatively flat since. While lower rates mean cheaper borrowing costs for financing acquisitions, the reason for the rate cuts should give dealmakers pause. Heading into 4Q, some sectors—specifically transportation and manufacturing—already appear to be in a recession. In such an interconnected environment, a downturn in one sector can have far-reaching consequences.

During 3Q 2019, we saw dealmakers act with additional caution as more gargantuan deals closed than were announced, with just three deals over $10 billion announced. The largest of these deals was CBS's (NYSE: CBS) $11.7 billion all-stock acquisition of Viacom (NASDAQ: VIAB), which put to bed a drama fit for network TV. Shari Redstone—vice-chairwoman of Viacom and CBS—is rumored to already be scouting out follow-on deals to target once the deal for Viacom closes.[1] This merger illustrates how content companies are vying for additional revenues and cost savings with M&A as they seek to compete with other content creators such as Discovery Communications (NASDAQ: DISCA), which purchased Scripps Network last year. Media companies are also trying to boost leverage in negotiating fees with vertically integrated conglomerates, such as Comcast (NASDAQ: CMCSA), which owns NBC Universal, and AT&T (NYSE: T), which just purchased WarnerMedia. Additionally, content creators are constantly negotiating with distributors such as Netflix (NASDAQ: NFLX), Amazon (NASDAQ: AMZN) and recently, Apple (NASDAQ: AAPL).

1: "CBS and Viacom Are Merging...But They're Still Not Big Enough to Compete with Netflix, Apple, or Disney," Vox, Peter Kafka, August 13, 2019

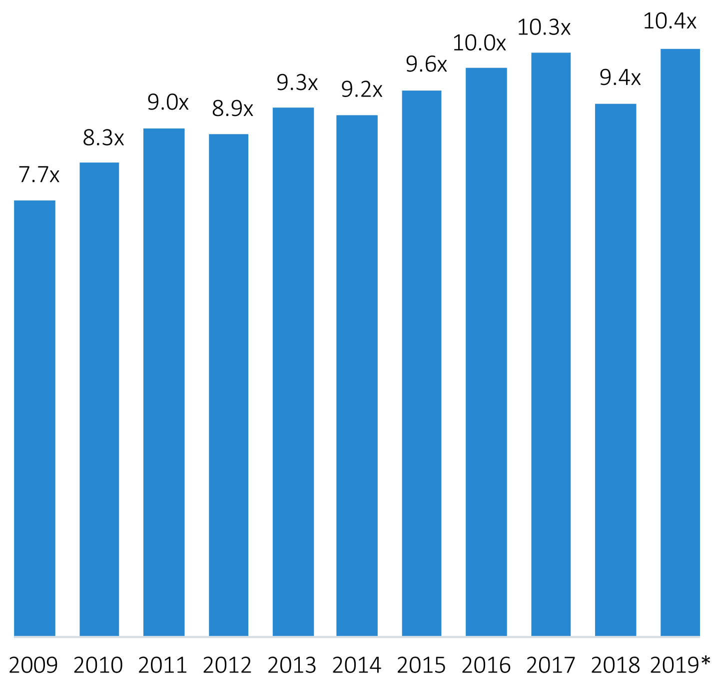
Elsewhere in the media landscape, we saw Disney (NYSE: DIS) sell its 80% stake in Yankees Entertainment and Sports (YES) Network to a conglomerate including Amazon and Blackstone (NYSE: BX), among others. The transaction valued the network at $3.5 billion, which is higher than the valuation of any Major League Baseball team except the Yankees themselves.[2] Another media transaction to close was Nexstar Media Group's (NASDAQ: NXST) $4.1 billion acquisition of Tribune Media. The deal came after Sinclair Broadcast Group failed to acquire Tribune last year. As margins and revenue growth remain under pressure in the industry, we believe more media deals are likely to follow.

Amid competition for assets in the media space and elsewhere, transaction multiples continue to climb. After 2018's seemingly anomalous results, median valuation multiples rose to the double-digits once again in 2019 to date. Lofty valuations are pervasive, spanning industries beyond just technology and healthcare (which tend to trade at the highest valuations). Multi-Color, a packaging company, was bought for $2.5 billion at an EV/EBITDA multiple of 15.5x by WS Packaging Group. Additionally, ZCL Composites, a liquid storage manufacturer, was acquired by ShawCor (TSE: SCL) for $233.2 million (C$312 million) at a 14.3x EV/EBITDA multiple. While these levels raise the headline price paid in an acquisition, low financing rates—further helped by the steep decline in the 10-year treasury rate in 2019—allow for more expensive deals to have reasonable costs.

Just as we have seen rising deal multiples, transaction sizes are also swelling. The median deal size is on a steep upward trajectory in recent years and has more than doubled in the past three years. Part of the increase can be attributed to higher multiples, as these cause buyers to pay more for the same EBITDA value. However, a cohort of gigantic public companies and PE firms have been pursuing enormous M&A transactions, causing deal sizes to rise more quickly than multiples. While this is an extreme example, Berkshire Hathaway (NYSE: BRK.A) now sits on over $120 billion and is hunting for an "elephant-sized acquisition."[3] In addition to holding companies flush with cash, 2019's prolific PE fundraising ought to buoy massive PE acquisitions for years to come.

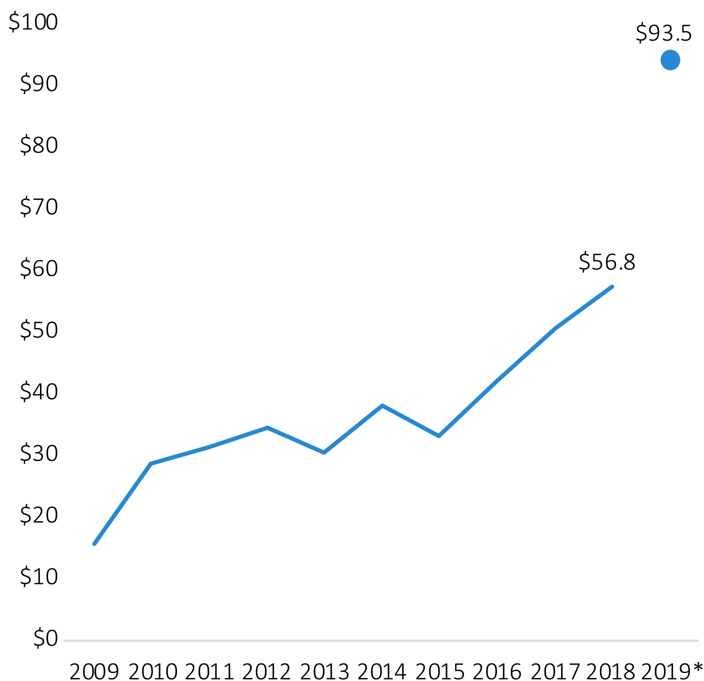
One broader movement we have seen is the increasingly tense relationship between the US and China being played out in the trade war. It seems that almost daily another aspect of the trade war is ratcheted up with additional tariffs or other financial threats such

Median M&A EV/EBITDA multiples



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

Median M&A size ($M)



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

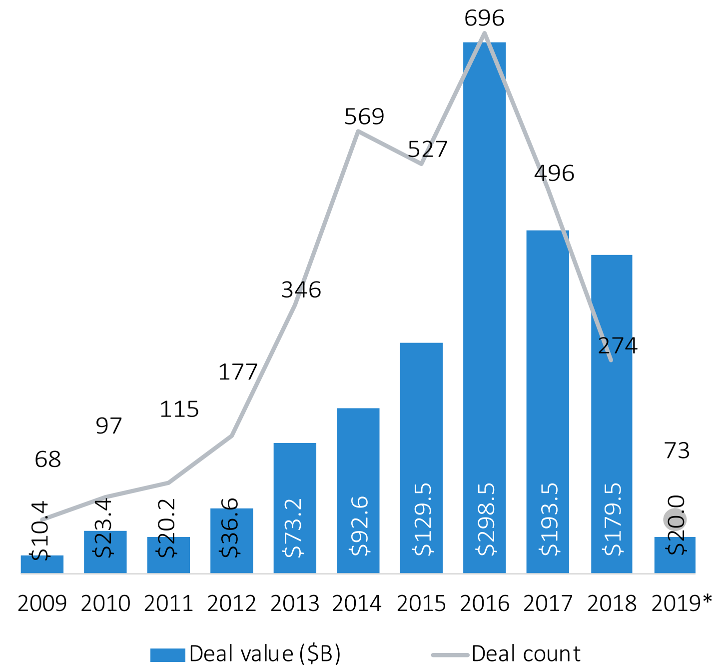
2: "Baseball Team Values 2019: Yankees Lead League at $4.6 Billion," Forbes, Mike Ozanian and Kurt Badenhausen, April 10, 2019
3: "Warren Buffett's Berkshire Hathaway Has Racked Up a Record $122 Billion in Cash," Markets Insider, Theron Mohamed, August 5, 2019

as banning Chinese companies from listing on US exchanges. M&A has been one of the areas hit hardest by the trade war, with deal value for North American target companies with a Chinese acquirer on pace to fall by over 90% since peaking in 2016. Not only have American and Chinese companies avoided doing deals together, but the US government has occasionally prevented deals from happening. The Committee on Foreign Investment in the United States (CFIUS) has already blocked Broadcom's $100 billion-plus attempt to purchase Qualcomm on national security grounds.[4] In addition, CFIUS has also overturned completed deals. In one high-profile case, Beijing Kunlun Technology Company had to sell US-based dating app Grindr after the deal had already settled. Government interference has inhibited investment as well, with CFIUS expanding its blacklist to include many high-profile Chinese tech companies, some of which have already received investments from US-based firms. Although it is uncertain how—or indeed if—the trade war will end, a protracted period of low cross-border investment between the US and China seems almost certain.

Although CFIUS may be impairing cross-border VC deal activity, M&A of VC-backed companies in North America is booming. The volume of VC-backed companies continues to increase, especially as the industry pours billions of dollars into startups and companies tend to stay private for longer periods. These high-growth companies make an excellent investment source for acquirers aiming to implement the newest technology. Many corporates have decided that in a fast-paced world, it is more cost-efficient to buy the competition than build a competitor in-house. As a result, an increasing amount of corporate research and development (R&D) dollars are going toward M&A.

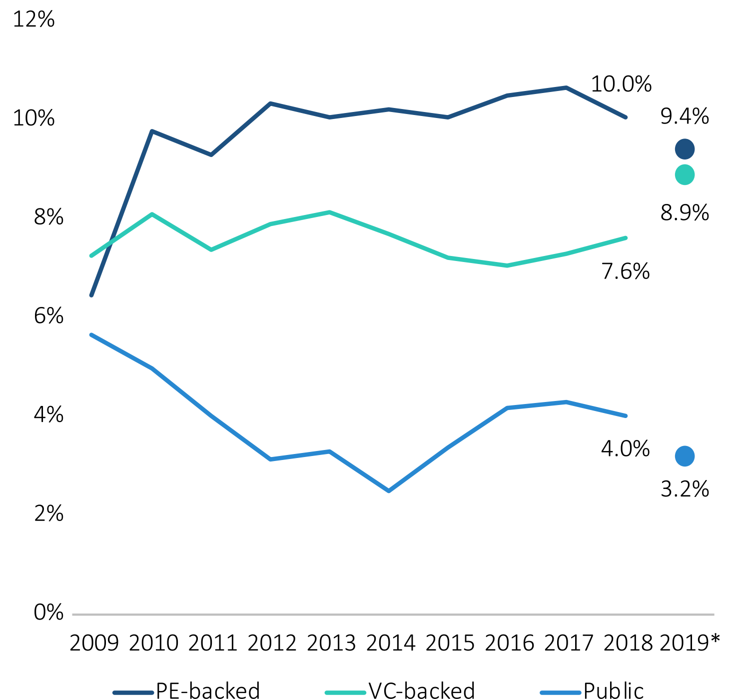
We expect this growth in the proportion of M&A sourced from VC portfolios to grow even further. The public market's frigid reaction to several deeply unprofitable VC-backed IPOs has investors and executives looking at alternative liquidity routes. Uber (NYSE: UBER) and Slack (NYSE: WORK) have dropped heavily after their public offerings. On top of this, the failed attempt to bring The We Company (née WeWork) public was a highly publicized calamity for all parties involved. With so much going wrong, several sizable companies such as Postmates have decided to postpone IPOs. Going forward, strategic or financial acquirers could offer the desired liquidity for investors and founders with less of the downside of publicly listing.

M&A activity with Chinese acquirers



Source: PitchBook | **Geography:** Global
*As of September 30, 2019

M&A (#) by backing status



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

4: "Trump Blocks Broadcom-Qualcomm Deal, Citing National Security Concerns," CNBC, Chloe Aiello, March 12, 2018

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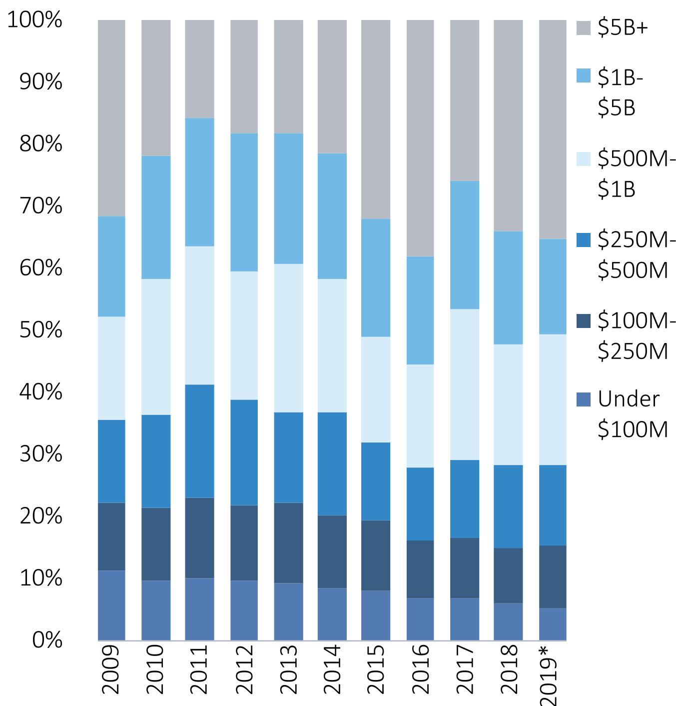
Deals by size and sector

M&A ($) by size



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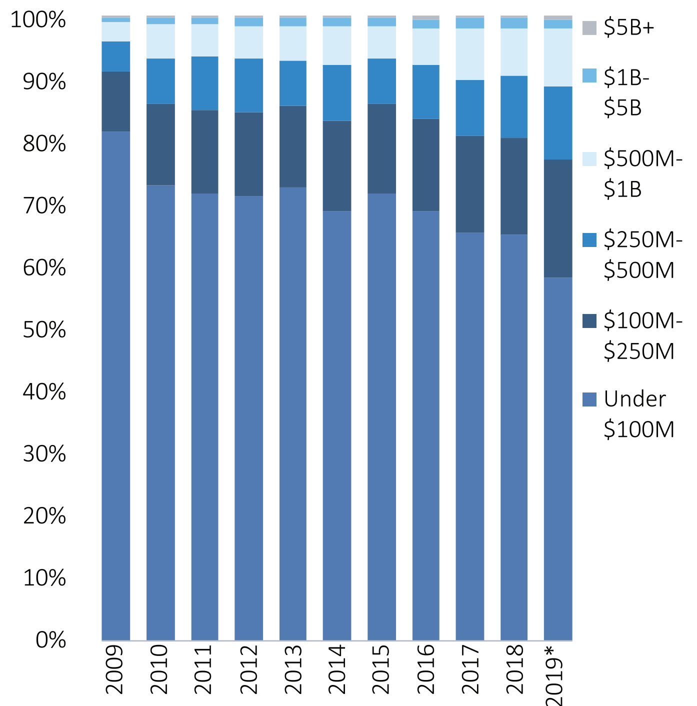
M&A (#) by size



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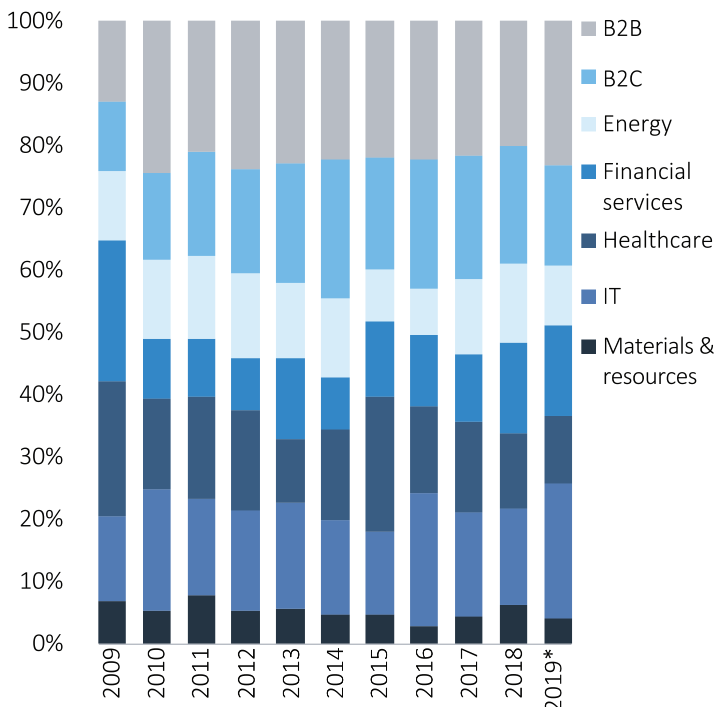
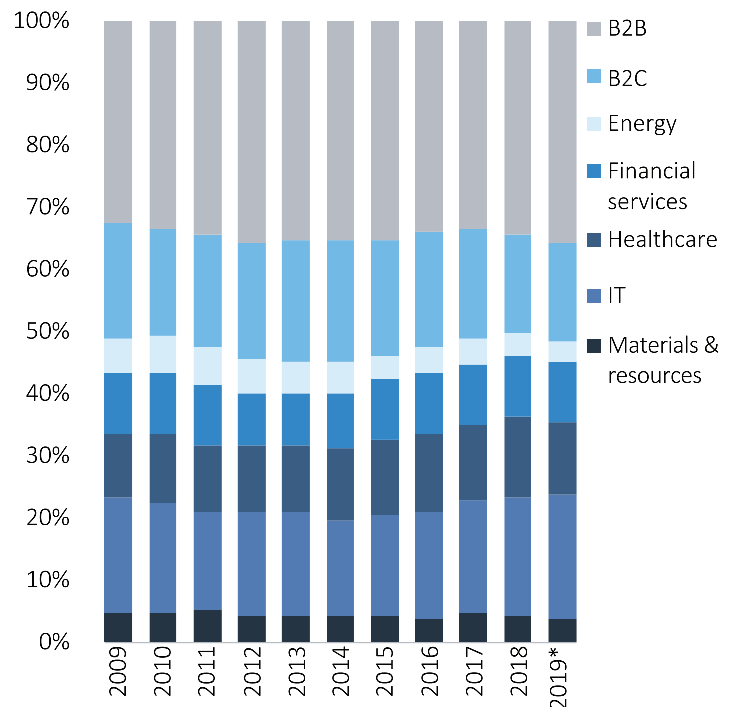
M&A ($) by sector



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

M&A (#) by sector



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

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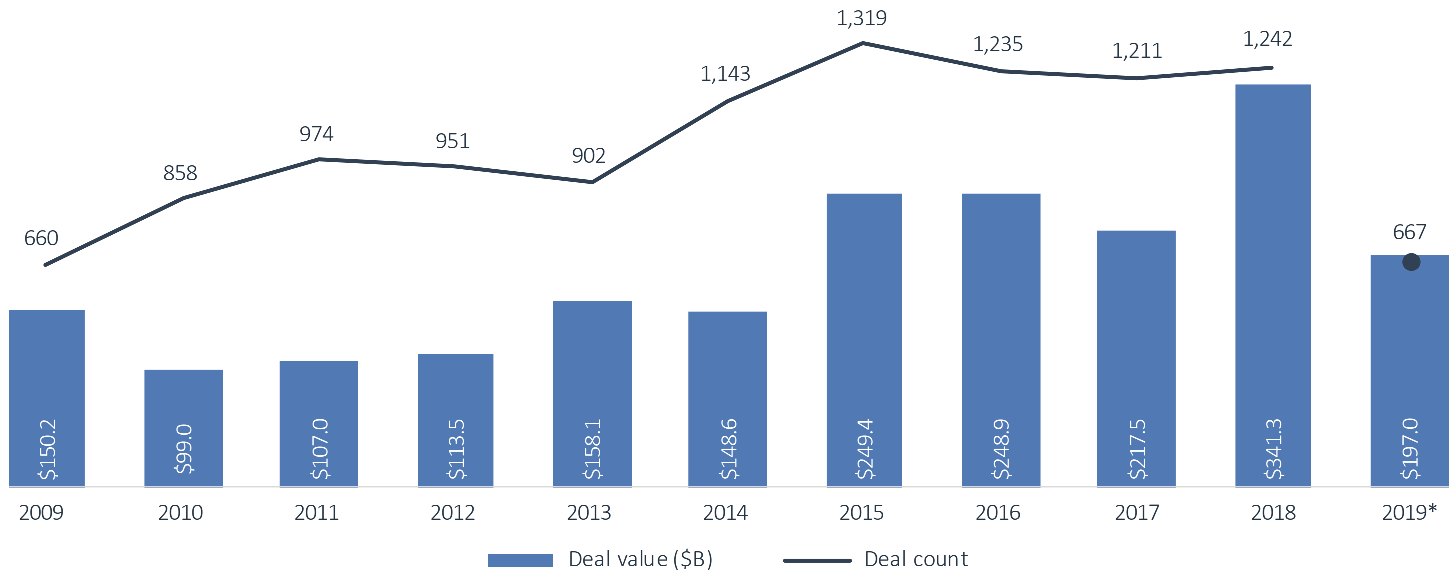
Spotlight: Financial services

Financial services M&A activity



Source: PitchBook | **Geography:** North America
*As of September 30, 2019

Through the first three quarters of 2019, dealmaking in the financial services sector has continued apace, with $197.0 million in value across 667 deals. By year end, we expect deal value will come close to matching full-year 2018 highs. In general, dealmaking in the sector—which includes companies in the banking, insurance, asset management, institutional and specialized financial industries—has been an extremely steady portion of the M&A environment, comprising 9.7% to 9.8% of deal flow in each of the last four years. These figures illustrate how central the sector is to overall M&A activity.

Within financial services, insurance has been a hotbed of dealmaking activity so far in 2019. Insurance brokerage M&A was a specific focal point in 2018, and prolific dealmaking in the subsector seems set to continue as PE firms favor the industry due to predictable margins and cash flow. Assured Partners, a middle-market insurance brokerage company based in Florida, was re-acquired in May 2019 by GTCR, who previously owned Assured until 2012. GTCR appears to be pursuing a buy-and-build strategy; Assured Partners has already bought nine companies via add-on deals since the acquisition. Another large insurance deal of 2019 was the take-private of Aspen Insurance Holdings by Apollo Global Management (NYSE: APO). This is hardly Apollo's first foray into insurance; it purchased Athene Holding in 2013 and has used insurance premiums from its investment as a low-cost source of permanent capital, a tactic that has spurred several other firms to follow Apollo's lead.

Elsewhere in the sector, banks have been steadily consolidating since before 1990. This still holds true as banks continue to consolidate for myriad reasons. It has been suggested that the Dodd-Frank Wall Street Reform and Consumer Protection Act led to regulatory-driven amalgamation (as well as a decrease in bank failures) mainly on behalf of smaller community banks that had to combine in order to handle the task of complying with new regulations. In addition, the Consumer Protection Act forbids big banks from acquiring smaller ones (though they are still permitted to grow organically). Data from a policy paper by the Minneapolis Federal Reserve Bank indicates that adding two members to the compliance department would make a third of small banks unprofitable, highlighting the impact of even slight regulation increases.[5]

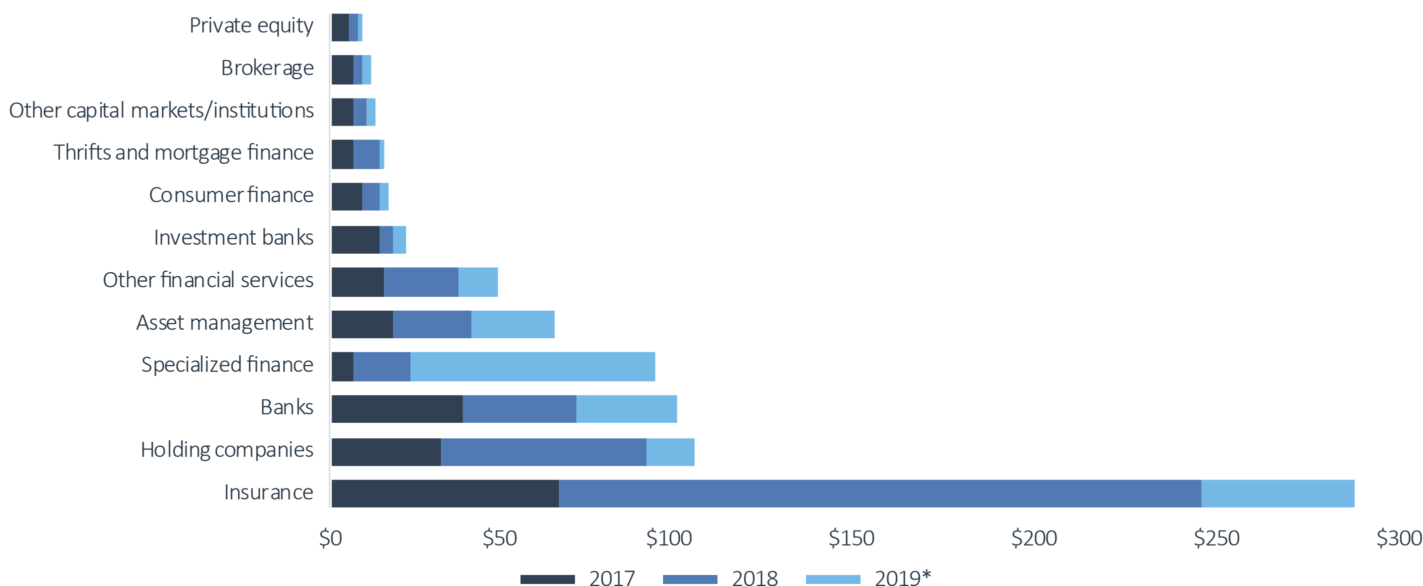
However, changes stemming from the 2018 Economic Growth, Regulatory Relief and Consumer Protection Act may further increase the speed of bank consolidation by allowing for growth without higher costs and increased

5: "Quantifying the Costs of Additional Regulation on Community Banks," Federal Reserve Bank of Minneapolis, May 30, 2019

scrutiny. The act raises the asset threshold requirements for small banks (above which they become more highly regulated), reduces reporting requirements, extends examination cycles and grants community banks exemption from the Volcker Rule in terms of proprietary trading and having relationships with hedge funds and PE firms. These regulatory rollbacks have led to regional and national banks consolidating for scale, as they now have the leeway to do so. Two deals completed in the quarter illustrate this trend. First, the acquisition of Michigan-based Chemical Bank by TCF Financial (NASDAQ: TCF) will create a larger player in the Detroit metro area (seventh largest in the area, with 5.6% of market share in Detroit and 8% of market share in Michigan). Second, the acquisition of Florida Community Bank makes Synovus Bank (NYSE: SNV) a top five regional bank (by deposits) in the Southeast.

Alongside regulatory shifts, the face of banking itself is changing. Brick and mortar banks are being phased out and access to services via phones, tablets and laptops is a growing path. More small and midsized banks are combining to stay alive in the face of increased digitization, a trend in which big banks can participate by expanding their technology budgets. For instance, J.P Morgan (NYSE: JPM) currently has an $11.4 billion technology budget, a 5.6% increase from their 2018 allocations in the space. One large merger that displays the impact of technological change and innovation is that of BB&T and SunTrust. The deal, expected to close later this year, will be the largest American bank merger since the financial crisis. The two banks will form a $66.0 billion company, creating the sixth largest bank in the US. Executives at both firms emphasized the importance that digitization had on the merger as both banks sought to expand to reduce costs, especially in technological advancement. The digitization of financial services is one avenue which can help level the playing field between large banks and their smaller competitors. Banks see technological disruptions coming from smaller VC-backed companies who are incrementally chipping away at profits by offering consumers easily accessible banking features. Often, startups will pay higher interest rates to provide their consumers with lower costs. Looking forward, we expect to see more banks embrace these changes through consolidating or acquisitions of smaller competitors to gain their technological capabilities. We also think it is likely that banks will acquire newer fintech companies to attempt to push to the forefront of the technological disruption occurring in the private markets.

Financial services M&A ($B) by segment



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