2019 M&A sector outlook

EY Transaction Advisory Services

Building a better working world

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Executive summary

Transformative M&A for a changing world

Strong economic fundamentals and continued sector convergence fueled US dealmaking in 2018. We expect a similarly robust M&A environment in 2019 but remain cognizant of enhanced global tension. From the rise of tariffs and protectionism to evolving international alliances, the shifting geopolitical chessboard is affecting how US companies define their strategic priorities, both near and long term.

Bill Casey

EY Americas Vice Chair
Transaction Advisory Services

To thrive amid this uncertainty, US executives are doubling down on dealmaking. Our recent Trade Barrier Impact survey finds that 86% of those affected by tariffs plan to pursue M&A in response to the volatility of international politics. An uncertain global landscape heightens the need for companies to critically assess how they're allocating their capital, domestically and abroad, including towards deals and joint ventures.

In 2019, we expect businesses to ask fewer questions about "whether" to pursue inorganic growth and more questions of "when" and "how." Enterprise technology, the lodestar for dealmaking, continues to remake business models, blur lines across sectors, and widen the field of M&A possibilities. We are seeing M&A become the fastest route to reinvention in today's digital economy.

The growing sway of private capital is also creating new possibilities for deals. Activists and private equity (PE) groups have raised record amounts of dry powder, which means greater competition for outright acquisitions. As a result, we expect to see more innovative financing partnerships between private investment groups and businesses in the year ahead, especially around divestitures. It also will mean more larger deals. 2018 has seen the most amount of deals in the US$5b to US$10b range on record. As the market corrects and PE firms seek to deploy their capital, we anticipate seeing this trend continue.

The strong M&A market means that integration is now more in focus as companies look to justify and monetize acquisitions. According to our most recent Capital Confidence Barometer (CCB), a majority of US executives (56%) say they are starting integration earlier in the M&A process, and 62% say they failed to sufficiently capture synergies from their most recent transaction. Now that M&A is a mainstay of companies' capital agendas, we expect a sharper microscope on the integration life cycle, which spans the reorganization of workforces, operations, accounting and long-term strategy during mergers.

What's next on the horizon for 2019 — politically, economically and technologically? We expect more transformation and for M&A to continue playing a central role. In today's complex, interconnected global economy, deals can help usher companies into their next evolution.

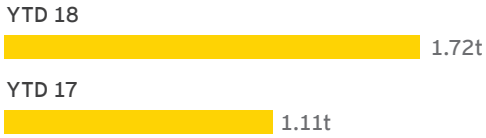
US overall M&A by volume and value YTD 2018

Volume

Change vs. 2017: ▲ 96

% change vs. 2017: ▲ 8%

Value (US$)



Change vs. 2017: ▲ 610b

% change vs. 2017: ▲ 55%

EY analysis and Dealogic; excludes real estate asset acquisitions. Deals with value US$100m+ and where a US company was either the target or acquirer. Each year includes deals announced (including pending and completed) 1 January–30 November.

Private equity

Transforming industries through technology, exit strategies

Industries across the corporate spectrum are being transformed by technology and convergence, and private equity firms are helping power this disruption.

"PE firms are putting a great deal of money into legacy companies to add technology, such as cloud capabilities, enhanced customer relationship management systems, financial reporting dashboards and other systems for leveraging data," Bill Stoffel, EY US Private Equity Leader, said. "They are hiring world-class chief technology officers at companies they own and bringing in chief digital officers at the firm level to improve their online capabilities."

At the same time, PE firms are helping rewrite the corporate script by enabling transformational deals when they sell assets.

Bill Stoffel
EY US Private Equity Leader
Ernst & Young LLP

"PE is looking further afield as it expands its buyer pool and selling assets to unexpected buyers outside of their immediate industries," Stoffel said.

PE firms have also been building up large war chests, as demonstrated by the increased number of deals in the US$5b to US$10b range and some even above that level.

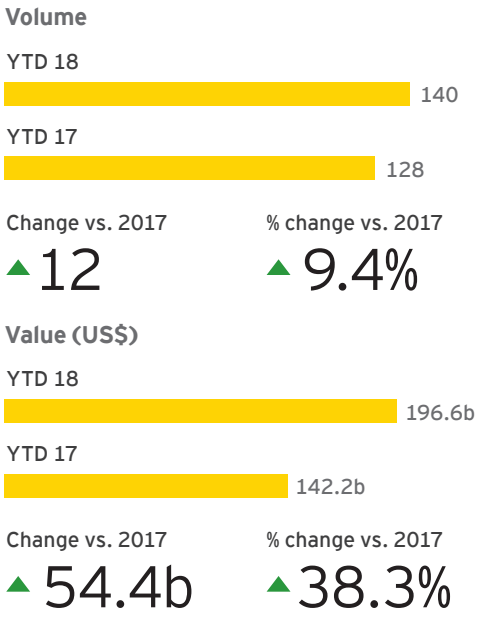
"Financing has been the enabler for private equity, and that's going to continue," Stoffel said. "Terms are very issuer friendly. Covenants have disappeared from most of those deals. Pullback from corporates and banks has enabled PE to become a larger part of the market." According to S&P's Leveraged Commentary and Data, covenant-light deals account for roughly four out of every five outstanding leveraged loans in the market today.

Higher valuations are changing the way PE firms look at deals. They now want to transform a business to enable long-term growth and better returns when it is time to sell, rather than looking for cost take outs and a quick exit.

"Multiples are so high, that if there's not an avenue for change, they don't want to do these deals," Stoffel said.

In 2018, average multiples for PE deals were 10.5 times earnings before interest, taxes, depreciation and amortization (EBITDA), according to S&P Leveraged Commentary and Data; this exceeds 2007's performance of 9.7 times EBITDA.

US private equity M&A by volume and value YTD 2018



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3 Private equity trends to watch in 2019

Data aiding (or making) decisions

PE companies are beginning to use big data to help make decisions on when to sell a business, with internal rate of return front and center. Data is helping private equity decide when it should look to exit, rather than trying to squeeze out a greater return.

"A lot of funds are saying 'why shouldn't we get rid of this?' instead of 'why should we get rid of this?'" Stoffel said.

However, a lot of work still needs to be done before predictive analytics can be used as the final arbiter of when to sell. The available data itself may not be robust enough.

"Nirvana for predictive analytics is indicating when to sell," Stoffel said. "We're not there yet. There is certainly a lot of room for improvement."

Greater emphasis on private capital markets

In recent years, there has been more reliance on private financing than on public markets. We've seen the number of listed companies in the US drop by half, while PE-backed companies have doubled.

"We've seen a shift in the way that capital markets are financing things," Stoffel said. "Long-life funds that can take a company from founding to a very mature stage are more common today. We are also seeing that even the more traditional growth-focused funds have elongated hold periods." Over the last three years, PE hold periods have averaged 5.5 years, compared with 4.5 years just a decade ago.

Where does that leave individual investors? Some on the US Securities and Exchange Commission have suggested the need to find ways for smaller investors to be able to invest in the private markets. This convergence of private and public markets could be a trend to watch.

Megadeals

We have also seen a recent uptick in the amount of $5b+ deals – 2018 has seen 12 deals in the US$5b–US$10b range, up 33% from last year, and the most since 2007. As the market corrects, we anticipate seeing an increase in larger deals, including ones in the $10b+ deal space as PE firms seek to put to work the record US$382b in dry powder that's available to fund new deals.

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Advanced manufacturing

M&A market pushes through geopolitical uncertainty

Advanced manufacturing companies are using M&A to add technology to their products, find the right talent in tightening labor markets and enter new markets. These driving factors should continue to carry M&A activity in 2019, despite headwinds from geopolitical uncertainty, including the current trade battle between the US and China and rising interest rates.

Over the past several years, companies in aerospace and defense, chemicals and industrial manufacturing have been both divesting to focus on their core business – sometimes at the behest of activist investors – and buying core strategy assets divested by others. They have also been making acquisitions outside of the sector to add technological innovation as they try to meet customer demand for a more services-led approach.

Geopolitical forces are also impacting manufacturing M&A. In our most recent CCB report, 48% of manufacturing executives surveyed listed regulation and political uncertainty as the biggest risks to dealmaking. This uncertainty includes tariffs on key inputs like steel.

Companies in the sector are showing signs of committing more to using M&A as a means of transformation, says David Gale, EY US Advanced Manufacturing Leader, Transaction Advisory Services.

David Gale
EY US Advanced Manufacturing Leader, Transaction Advisory Services
Ernst & Young LLP

In this way, these companies have been rewriting the script to enable sustainable growth in an uncertain, technology-driven future. We would expect these trends to continue and funnel down from the largest to small and medium-sized companies.

"In the next six months we might see some larger breakups," said Gale. "This will create opportunities for others in the market to acquire what the larger companies divest."

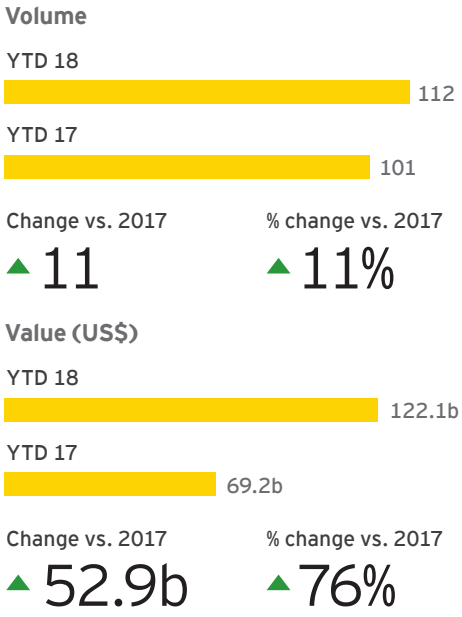
At the same time, talent is becoming more of a focus. With a tighter labor market, manufacturers will rely on acquihires to bring in a skilled workforce, and companies with higher functioning workforces could become attractive targets for the workers themselves.

Valuations are also rising as private equity firms, with a great deal of cash to deploy, bid for assets. At the same time, rising interest rates are increasing costs for companies looking to finance acquisitions with debt.

But while these headwinds could slow the M&A pace on the margins, we expect the driving forces of technology, industry convergence, deployable cash, and a push to focus on and build core businesses to drive continued dealmaking.

"There is geopolitical concern, but you keep moving forward. Companies know they need to innovate to drive long-term growth," Gale said.

US diversified industrial products M&A by volume and value YTD 2018



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3 Advanced manufacturing trends to watch in 2019

Technology influences deals

Technology demands will be one factor driving M&A as companies add technology to products and evolve to become more efficient manufacturers.

"I would expect the next wave of technological M&A is going to include the industrials," Gale said.

Aside from acquiring technology to pair with products, manufacturers are also seeking technology to help them move more toward a digital supply chain. Likewise, robotics and artificial intelligence assets will be critical to making the manufacturing process leaner.

"Companies need to get more accustomed to thinking about digital within everything they are doing. Look at the manual functions within your organization, can these be updated to perform automatically and digitally?" Gale said.

Middle market takes up the next phase

The primary driver of dealmaking activity has tended to be larger middle-market deals in the US$2b–US$3b range, as the biggest manufacturers try to strengthen their core businesses, seek the efficiencies of scale and look to new markets.

We expect the next wave to impact the middle market with smaller companies honing their focus. There will be both buying and selling at those levels, as companies divest non-core assets, and buying as these companies add to their core businesses.

"This is how small to medium-sized companies are going to survive," Gale said. "They will be acquisition targets if they don't identify a niche to operate in." This includes focusing on unique products and unique geographies and enhancing customer services.

Geopolitical change and geographic expansion

Manufacturing executives tend to be conservative relative to their peers in certain other sectors, and when their key inputs are caught in a tariff battle, that can lead to increased caution. We expect more clarity in the trade environment in 2019 to help give better direction to deal activity.

At the same time, US manufacturers are looking outside of China to increase their options and diversify, and even considering onshoring opportunities. While a potential solution, manufacturing outside of China takes time to establish.

Larger companies are also looking to expand in emerging markets to fuel growth. Target markets are company specific but can include China and Brazil, despite trade uncertainty in the former and political uncertainty in the latter.

Further down the road, India will likely also be a target market. "It's a huge country with so much skilled labor. India will come into play soon, but the infrastructure isn't there, yet," Gale said.

Aside from acquiring technology to pair with products, manufacturers are also seeking technology to help them move more toward a digital supply chain.

Consumer products and retail

Challenging legacy companies with new technology and models

Consumer products and retail companies are turning to M&A to help spur growth through both traditional deals and smaller investments that provide the chance to experiment with new technologies and business models.

In some cases, activist investors are driving deals for scale and cost efficiency. In others, companies are carefully examining their portfolios and divesting non-core assets. Expansion into new geographies also continues to be a priority.

These trends are likely to continue as companies balance technological disruption with increasing demands by consumers for personalized products, experiences and convenience. Consumers continue to be increasingly interested in the provenance of the products they are buying creating the desire for ethical brands and a deep appreciation for the purpose those brands stand for.

Katie Johnson
EY US Consumer Products and Retail Leader, Transaction Advisory Services
Ernst & Young LLP

"All companies are facing disruption, but the key is their willingness and ability to adopt new business models or adapt traditional value creation models. Many of these companies are protecting their legacy, and it is challenging for them to disrupt themselves," said Katie Johnson, EY US Consumer Products and Retail Leader, Transaction Advisory Services.

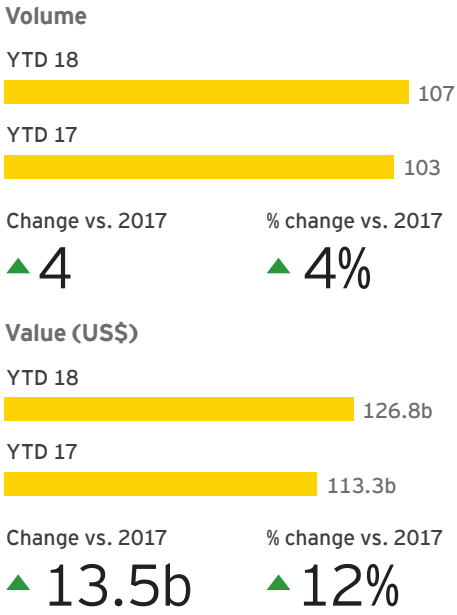
Consumer industry companies are rewriting their future by acquiring fast-growing startup brands, securing new technology that allows them to more nimbly respond to and connect with consumers, and focusing on product and experience.

"This is a challenging environment for CPG (consumer packaged goods) companies," Johnson said. "Relationships with retailers make launching a direct-to-consumer brand or acquiring one more difficult."

But CPG companies also need to be highly strategic in their integrations. Moving too quickly may alienate loyal consumers, and slowing it down could mean losing the critical benefits of synergies.

The key for consumer industry companies in 2019 will be what steps they are taking to profit from disruption.

US consumer products and retail M&A by volume and value YTD 2018



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3 Consumer products and retail trends to watch in 2019

Technology

Big technology investments are likely to continue in 2019. These investments could follow the lines of L'Oreal's acquisition of Canadian company Modiface, which developed augmented reality technology behind virtual makeovers in the cosmetics space, and Kroger's pilot with automated warehouses and driverless delivery cars.

"The trend has been to form alliances or make investments through internal corporate venture capital incubators to gain access to talent and technology without an outright acquisition," Johnson said.

Technology is also changing who — or what — is actually doing the shopping and what types of jobs there are to serve them. "The consumer sector will continue to be heavily impacted as technology drives greater efficiency and influences the consumer's path to purchase through real-time customer engagement," Johnson said.

Health

The consumerization of health care driven by the way people think about personal health and their desire to engage will continue to shape CPG and retail strategy. The focus on greater authenticity and transparency, as well as expectations for product and service delivery, is impacting food to personal care to retail. Many disruptive competitors are gaining traction in health and wellness through an integrated offering focused on personalization and convenience, such as meal kits and personalized vitamins.

The convergence of data, product and services will be a key driver of investments in consumer and retail health in 2019. Retail stores could evolve as a hub for consumers seeking care, and CPG companies will continue to look for investments centered around wellness from healthy snacking to over-the-counter (OTC) to skincare.

Ethical M&A

Recently, consumers have shown they want to hold companies accountable for producing more ethically-conscious goods. We're seeing this across the consumer products and retail sector, but particularly in the cosmetics and beauty industries. Vegan and fair trade beauty products are becoming critical for larger beauty companies to carry and will be another driver of M&A trends in 2019.

Purpose is also a key factor in brands making themselves more attractive. More than ever, people care about what a brand stands for and want to be associated with organizations that are in line with their own principles.

For example, the world's biggest cosmetics manufacturer bought a German manufacturer of vegan beauty products, increasingly in vogue with the French group's customers. The transaction was to expand sales of the German company's brands internationally, and especially in Western Europe. This built on its push for plant-based products in recent years, at a time when shoppers are becoming more wary of chemical ingredients and are seeking natural alternatives aligned to their environmental views.

Similarly, across big food groups there is a shift to acquiring niche brands, with the central value proposition being ethical, sustainable sourcing of ingredients.

Financial services

US market ripe for M&A driven by quest for technology, scale

The outlook for mergers and acquisitions in the US financial services industry looks healthy heading into 2019. Regional banks and asset managers continue to look for scale and regulations ease, while innovation, technology and customer expectations continue to disrupt business models in insurance and consumer-facing financial services.

Less stringent criteria for what constitutes a systemically important financial institution (SIFI) leaves room for larger banking deals. At the same time, tax reform has given financial institutions more flexibility to deploy capital towards acquisitions and investments in technology.

"The financial services industry is bullish on M&A, and US companies are even more confident than what we are seeing globally," Nadine Mirchandani, EY US Financial Services Leader, Transaction Advisory Services, said.

Nadine Mirchandani
EY US Financial Services Leader, Transaction Advisory Services
Ernst & Young LLP

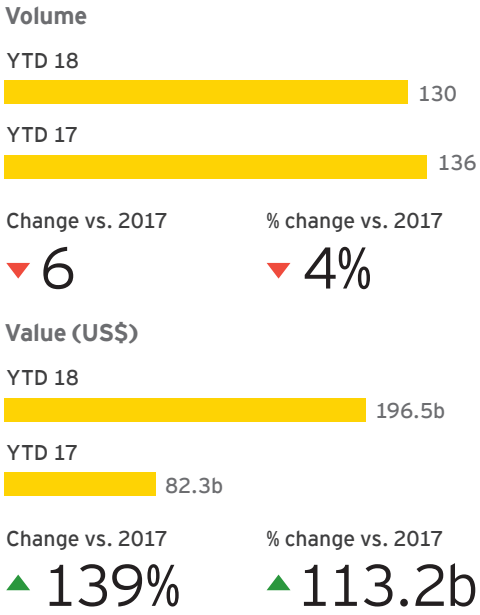
On the consumer side, financial services companies are embracing technology to enable new ways of making payments, investing, giving wealth advice and offering loans. On the wholesale side, technologies like blockchain may have the capability to transform transactions, settlement and clearance services.

"There's a good chance that the future of consumer financial services could be vastly disrupted by customer-oriented platforms, and the wholesale part of financial services could be disrupted by alternative means of transaction processing," Mirchandani said.

Data strategies are also evolving as financial services companies leverage data to help transform their business. M&A is being used to not only acquire clients, market share and product reach but also scale talent capabilities in areas of technology, data, science and engineering.

"The discussion we have with clients is about the pace of change," Mirchandani said. "The buy part of the buy-versus-build equation is winning because building a capability may take too long."

US financial services M&A by volume and value YTD 2018



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3 Financial services trends to watch in 2019

Financial services where and when in life you want them

Advances in technology have enabled financial services to become a seamless part of our everyday lives – embedded into apps and available on demand. We are still in the early stages of this journey, and there will be continued integration of holistic financial services in the year ahead in the areas of insurance, wealth and banking. We expect to also see the evolution of consumer financial services customization continuing the journey of frictionless customer experience in key life moments. "There will be more investment in bespoke technology capabilities for specific phases of life, such as taking out student loans for graduate school or a first mortgage," Mirchandani said.

The insurance industry is emerging as a key driver of innovation across financial services. Big insurers, smaller insurtech and everything in between are exploring how to digitize the insurance life cycle, employ internet of things (IoT) to incorporate live data into risk profiles, and even operate drones to assess climate risks across different regions. This innovation is generating more competition across the industry; creating a robust environment for carve-outs, buy-and-builds and other M&A strategies; helping to set the tone for innovation across the sector.

Leveraging data

Financial services companies have long had strategies for analyzing and using data, but those strategies are evolving to see data as a way to transform the business. We see our clients looking to use acquisitions to transform their data strategy.

"Clients are saying 'If I buy these capabilities, I can have a different strategy around data as an asset,'" Mirchandani said.

The value of data may also bring new competitors into the financial services space. Technology giants that hold a wealth of consumer data could theoretically leverage that data in financial services – if regulators let them.

"There's no doubt that, given the data they have and if they can cross regulatory hurdles, they will be formidable players. They know their customers so well," Mirchandani said.

Online and digital models keep gaining importance

The shift to online and digital models will continue to be a key M&A driver. In one example of how important these models are becoming, earlier this year, a large investment bank said it would integrate its online lending and banking platform into its wealth management business.

But growing these models requires a shift in what financial services companies need to acquire. It's not only financial assets anymore. It's broader expertise.

"Companies need to acquire innovation, and the talent to drive that innovation," Mirchandani said.

This innovation is generating more competition across the industry; creating a robust environment for carve-outs, buy-and-builds and other M&A strategies; helping to set the tone for innovation across the sector.

Life sciences

Financial firepower ready to invest amid industry convergence

Life sciences companies head into 2019 with the financial ability to use M&A in niche and transformative deals in an industry where scientific and technological advances create new opportunities for more personalized medicine.

EY analysis suggests US tax reform and funds captured from divestitures have boosted the cash available for acquisitions. But life sciences companies remain cautious because of increasing trade tensions and uncertainty around regulation and pending legislation.

"Companies have the firepower to do deals, but they aren't deploying it," Ambar Boodhoo, EY US Life Sciences Leader, Transaction Advisory Services, said.

Meanwhile, the industry story is rapidly changing. Digital health and technology entrants are moving from fitness monitoring to disease management, potentially encroaching on traditional life sciences markets. Additionally, the consolidation of different health stakeholders, such as payers and drug store operators, underscores just how quickly the drug supply chain is transforming.

Ambar Boodhoo
EY US Life Sciences Leader, Transaction Advisory Services
Ernst & Young LLP

In recent years, this convergence has accelerated, highlighting the growing importance of technological collaborations. As the volume and variety of health data increase and with a greater need for process efficiencies, companies recognize the growing importance of artificial intelligence (AI), robotics and automation, cloud computing, IoT, and blockchain. Indeed, major pharma companies are collaborating with tech players to leverage these solutions across the value chain.

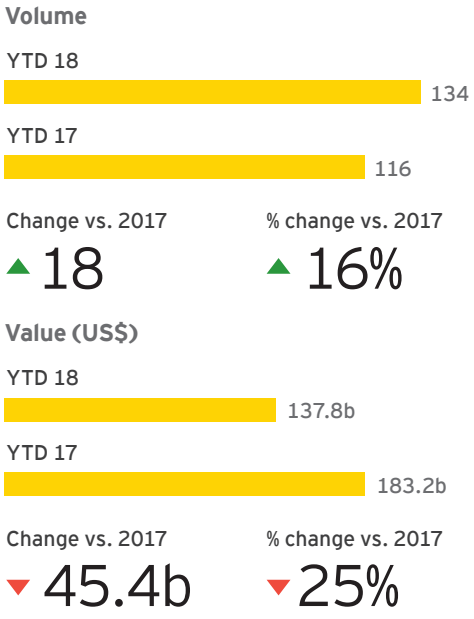
"Value will come to those who can produce innovative health outcomes tailored to individuals, with a high degree of precision and personalization," Boodhoo said.

Digital acquisitions are clearly an important part of companies' strategy, and in our latest Digital Deal Economy Study, 60% of life sciences respondents said they were looking at M&A, joint ventures and alliances for digital growth.

In 2019, we expect companies will continue to review and enhance their portfolios, narrowing their focus and divesting non-core assets.

As certainty emerges around trade and regulation, look for life sciences companies to deploy their financial firepower to enhance their care in a personalized, digital world.

US life sciences M&A by volume and value YTD 2018



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3 Life sciences trends to watch in 2019

Disruption

More companies from outside the traditional life sciences industry are participating in the health care ecosystem, across the product life cycle and care provision. "A patient-centric health system is emerging," Boodhoo said. "There is a shift toward a more integrated model, with organizations, communities and social care providers coordinating their services and patients behaving as active partners in their own health."

Life sciences companies must adapt to this disruption by collaborating with new entrants to create platforms of care. In the short term, these collaborations are likely to be alliances, not transformative acquisitions given the uncertain return on investment and the rapid pace of technological change. As digital alliances bear fruit, however, they set the stage for more digital acquisitions in 2020 and beyond.

Focused companies are more prepared for a digital future

If companies are going to get closer to the patients, providers and payers they serve, they will need to build end-to-end capabilities that take advantage of digital capabilities. But because of the up-front costs, companies won't be able to afford to invest in these new capabilities at sufficient scale across a range of diverse businesses.

This scarcity is going to force companies to make hard choices about which therapy areas will win, accelerating efforts to create more focused business models. Dealmaking will continue to be a key way companies achieve the critical mass they need for commercial success. But rather than megamergers, the priority will be acquisitions that allow companies to create therapeutic depth without adding portfolio complexity.

Precision medicine comes of age

Precision medicine, targeting the right treatment for the right patient at the right time, has taken its place in the portfolios of major biopharmaceutical companies. The products and services necessary for success are creating new dealmaking opportunities across the entire value chain.

In 2019, as more competitors, therapeutic areas and truly "individualized care" emerge, health systems worldwide will continue to scrutinize payment and channel dynamics, encouraging companies to develop their value arguments and supply chain plans with more rigor than ever before.

> If companies are going to get closer to the patients, providers and payers they serve, they will need to build end-to-end capabilities that take advantage of digital capabilities.

Media and entertainment

Owning key capabilities and buying scale

Media and entertainment (M&E) companies head into 2019 focused on M&A to acquire key customer relationships, technological capabilities, content and scale.

2018 was highlighted by megadeals that either were announced (Disney-Fox, Comcast-Sky) or that cleared a major legal hurdle (AT&T-Time Warner). These deals are emblematic of M&E using transformative M&A to gain more direct access to customers (and their data) and to acquire content to fill new platforms.

We expect that trend to continue in 2019, with mid-tier and smaller companies feeling pressure to transact.

"Unless they have a truly unique niche that is sustainable, they will have to partner up," John Harrison, EY Global Media & Entertainment Sector Leader, said. "Fortunately, at least in some areas, companies are divesting assets to achieve regulatory approval for a deal or as part of regular business portfolio reviews, creating incremental opportunities for buyers."

John Harrison
EY Global Media & Entertainment Sector Leader

The M&E sector was among the earliest to feel the disruption that comes from convergence, with competitors from technology and telecoms producing content and delivering it directly to consumers. The sector leaders now realize the importance of acquiring technology to launch direct-to-consumer (over-the-top) platforms and investing in advertising technology to deliver targeted, compelling advertising experiences. M&E companies are also experimenting with how AI may be used to automate portions of both the creative and "green-light" decision-making process.

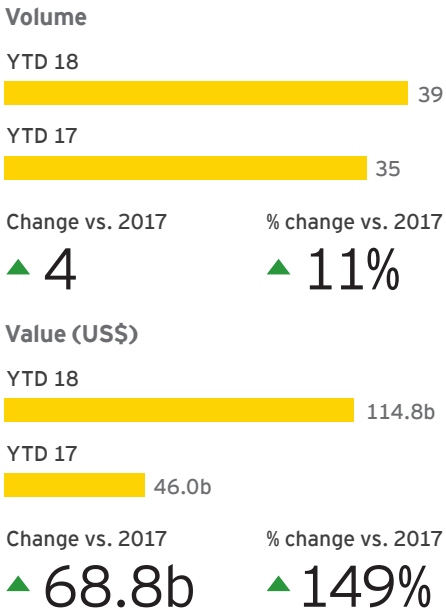
"If it's a capability that is truly strategic to future growth, companies are going to be more inclined to own the process and underlying technology," Harrison said.

At the same time, major global acquisitions face more regulatory scrutiny. The US government has appealed the ruling that allowed the AT&T-Time Warner deal to proceed, while trade tensions with China are causing uncertainty.

One thing is certain from our discussion with clients – they want to make sure they have the right capital structure in place to capitalize on opportunity.

"Clients want to avoid becoming strategically isolated as others consolidate around them," Harrison said. "They don't want to miss the window."

US media and entertainment M&A by volume and value YTD 2018



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3 Media and entertainment trends to watch in 2019

Shifting landscape

How content reaches consumers will continue to shift significantly in 2019. The sale of the Fox regional sports networks will be one story to watch. Also, Disney's launch of its own subscription video on demand (SVOD) platforms will impact other streaming video providers that previously licensed Disney-owned content – content that will be redeployed exclusively on the new Disney over-the-top (OTT) media services offerings. This could become an even more important industry-wide theme as M&E companies look to own the customer relationship directly.

Sports rights remain in focus, globally, with expectations rising for aggressive bids by internet and digital media leaders to expand their reach into live programming with wide audience appeal.

Content evolving to meet consumer needs

As customers view more content on the go through their mobile devices, media companies are also looking to tailor that content to fit the viewing occasion. A possible future with autonomous driving is also opening the window for more content consumption.

This is leading to investment in short-form content that fits into more abbreviated consumption windows. This includes investments in platforms that will feature scripted content with high production values.

Convergence in overdrive

We have already seen the convergence of technology, M&E and telecom companies, with technology companies producing content, M&E companies developing OTT services to deliver content and mobile devices serving as an important viewing (and data-gathering) platform.

The next phase of evolution is demonstrated by the blurring of content, technology and consumer products. One example is Peloton, an internet-connected exercise bike that has an interactive screen and delivers content in the form of streaming cycling classes.

We expect more cross-sector consolidation that will enable media and entertainment companies to participate in, and benefit from, all areas of disruptive innovation and industry change.

As customers view more content on the go through their mobile devices, media companies are also looking to tailor that content to fit the viewing occasion.

Technology

Transformative deals should keep driving tech M&A

The technology sector is seeing record M&A valuations, driven by PE investors continuing to double down on the sector, and the biggest technology companies looking to grow, expand and reshape their capabilities. Corporates, from outside the sector, are also attempting to secure their futures by adding key tech capabilities through M&A.

We anticipate the major factors that have driven M&A, including disruptive forces and pent-up demand, will likely continue to drive transformative deals as large companies update their portfolios.

Consolidation is occurring across the market, most notably in cybersecurity and semiconductors. In the former, the market is buoyed by new entrants and increasing focus at the board level, while customers would prefer to work with fewer security vendors. In the latter, portfolios require reshaping into faster growing segments such as IoT and automotive, while cost economics require ever-increasing scale.

Barak Ravid
Technology Co-head
EY-Parthenon

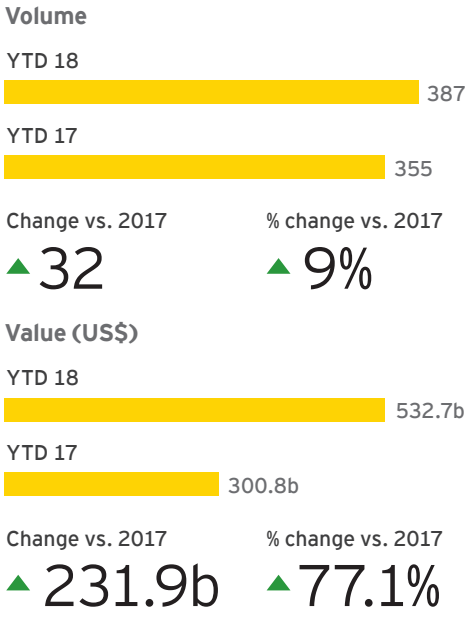
Technology-focused PE investors continue their ever-increasing interest in the sector and are adding to the competition for assets, helping to drive up valuations.

"Tech is still in the middle innings of the latest cycle of innovation. Digital is not only disrupting the sector, but also forcing companies across industries to acquire technology assets to ensure future growth," said Barak Ravid, Technology Co-head, EY-Parthenon. "As the tech titans mature and grapple with slowing organic revenue growth, we expect more divestitures of non-core assets and big, bold acquisitions. Non-tech acquirers are responding to the urgency of digital transformation with the fastest route available – M&A."

Despite the long-term factors that are driving M&A in and around technology, executives are being more cautious about M&A in the near term. This sentiment may be reflected in the number of tech deals announced; tech sector M&A volume was up 1% year-to-date, according to 451 Research. However, the technology deals being announced have been big, with aggregate deal value up 54%.

"Technology companies are looking closely at their portfolios, and they see the need for continued consolidation to seize new opportunities and to be the disruptors instead of the disrupted," Ravid said.

US technology M&A by volume and value YTD 2018



EY analysis and 451Research; excludes real estate asset acquisitions. Deals with value US$100m+ and where a US company was either the target or acquirer. Each year includes deals announced (including pending and completed) 1 January–30 November.

3 Technology trends to watch in 2019

Companies looking outside the US

Protectionism and regulatory concerns are top of mind among tech companies. While tactical playbooks have been adjusted to cope with both geopolitical and macroeconomic uncertainty, trade tensions with China have practically led to a halt in China/US M&A. This has pushed tech companies to spend more time shopping for new M&A targets outside the US.

The value of deals made by US companies acquiring outside the country in 2018 is set to break through the record set in 2017 to more than triple the value of such deals relative to 2016, according to 451 Research. "While these factors are concerns for tech executives in certain sensitive segments, for now they are not enough to get in the way of the large spike in US tech companies pursuing cross-border transactions in search of growth," Ravid said.

Tech-focused PE forcing out competition

Private equity investors have continued their now decade-long increase in appetite for tech assets, with the tech-focused PE investors raising ever larger funds. At the same time, a growing number of more generalist PE investors have also increased their focus on various segments of the tech market.

In 2019, there could be a shakeout. As interest rates increase, along with lofty tech valuations, some of the more tech-focused PE firms believe this may be an opportunity to drive out more generalist competition from an increasingly crowded market.

Buying instead of building to gain tech skills

Technology has disrupted industries from consumer products to health care to manufacturing. Companies in these sectors are increasingly looking to M&A as a way of getting the technology they need to reach shoppers, improve care, develop products and offer comprehensive platforms to customers.

We expect these companies to continue to be suitors for tech assets in 2019 as they feel an increasing urgency to transform digitally.

Companies are consistently citing the need to find not just the right technology, but the right people to understand and leverage that technology as a driver for M&A.

"Transformation is fast moving, and M&A is a quicker solution than trying to organically develop the skill sets and tools companies need to drive innovation in the years to come," Ravid said.

> Companies are consistently citing the need to find not just the right technology, but the right people to understand and leverage that technology as a driver for M&A.

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