Hogan Lovells
Deal Dynamics
Insights on cross-border M&A
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Diversified industrials look across borders for deals as M&A volume surpasses all other sectors

- Highest cross-border deal volume across all sectors for third consecutive quarter (350 deals)
- Deal volume for Q3 is 9% above the quarterly average since 2010
- Deal value is up 11% year-on-year (US$52.7bn)

M&A deal value in Q3 surged as industrial groups are under continued pressure to improve productivity and ensure they remain relevant. The sector attracted the second highest cross-border deal value across all sectors in Q3, with a total of US$52.7 billion-worth of transactions announced. This stands 15% above the average quarterly value since 2010 (US$45.6 billion) and marks an 11% increase on the same period last year (US$47.5 billion).

However, a total of 350 deals announced over the quarter marks a decrease of 48 deals compared with Q2 (398), as buyers gravitate towards the larger end of the dealmaking spectrum.

After recovering from uncertainty in 2016, M&A deal value in the diversified industrial market has continued to recover and grow since 2017. Although geopolitical and economic uncertainty continues to impact investor confidence, the market is demonstrating resilience, with growth expected to continue beyond 2018.

Mergers of equals

This expansion in the market is evident by the number of high-value megadeals in Q3. The largest deal of the quarter saw packaging group Amcor buy United States rival Bemis for US$6.7 billion, in a “merger of equals” that saw the bidder, an Australian company, gain a foothold in North America. The merger would create a global leader in the consumer packaging industry, according to Bemis’ president and CEO, William F. Austen, who hailed the deal as “transformational”.

The Bemis/Amcor tie-up is just one example of consolidation across various industry sub-sectors. For instance, Japan's Taiyo Nippon Sanso Corporation acquired the European assets of fellow industrial gases maker Praxair for US$5.8 billion, as the latter honed in on its key North and South American markets.

Furthermore, Indian agrochemical producer UPL Corporation acquired 100% of the stock of Japanese counterpart Arysta LifeScience Corporation for US$4.2billion in the industrials sector's third largest cross-border deal of the quarter.

Both deals are partly debt-funded, and appear to be part of a larger trend responding to the prevailing negative interest rate in Japan. Interestingly, the deals are the latest in a series of outbound Japanese M&A transactions which demonstrate the country’s appetite for overseas investment.

Productivity, sustainability, and technology

Broadly speaking, one of the challenges within the industrials sector, and one which is a motivator for engaging in M&A, is the pressure to improve productivity. Many sub-sectors are already mature and well developed, leaving less headroom for efficiency gains. In addition, ageing populations in developed countries are creating productivity ceilings.

One solution to this is to cut costs by pursuing mergers. Indeed, Bemis agreed to its takeover by Amcor as it struggles to increase packaging sales in the United States and Latin America, its biggest markets. Through more collaborative and streamlined supply chains, it is estimated that US$185 million in annual expenses will be saved through the merger.

However, cost-cutting has its limits. The key to unlocking sustainable growth lies in innovation. This has given rise to technology-enabled deals emerging across all sectors. As technology continues to improve, we have seen a number of diversified industrial companies acquiring tech companies that complement their business and improve their ability to service their clients.

Siemens, the largest industrial manufacturing conglomerate in Europe, has invested US$10 billion in software companies since 2007 and anticipates double-digit growth from its digital business through 2020. In the most recent example of its digitalization strategy, the German company acquired Mendix, a US application development platform, for US$700 million in August.

Private equity comes to the party

Meanwhile, private equity (PE) groups are bringing record levels of capital to the negotiating table. Buyout deals are up 60% on last year. This is set to continue, with many PE firms holding significant reserves yet to be invested.

As investment opportunities in the diversified industrial market simultaneously rise, they will offer attractive investment opportunities. We also expect that buyout houses will accelerate their M&A activity in the market.

Cross-border hurdles

Despite the opportunity for industrial groups to achieve growth through cross-border M&A (whether by acquiring direct rivals, moving into adjacent product categories and markets or buying tech assets), challenges remain.

Ongoing tensions between the United States and China could threaten cross-border M&A activity, particularly for industrial companies that supply sectors whose products face new tariffs, making them less competitive.

A further complication, particularly concerning buyers seeking assets with a tech angle, is the United States' increasingly defensive position on inbound investment. In August, Congress passed the Foreign Investment Risk Review Modernization Act (FIRRMA), expanding the scope of the Committee on Foreign Investment in the United States (CFIUS), the body responsible for reviewing the national security implications of foreign investments in US companies.

While protectionist policy hurdles add complexity and create uncertainty, the fundamental motives for deal-making remain in place. There is a strategic imperative for industrial groups to merge in order to bring down costs, tap into new markets, and access technologies to help them respond to ongoing disruption, thus achieving productivity growth amid muted organic growth conditions.

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