Baker McKenzie.

2018

GLOBAL TRANSACTIONS FORECAST

Industrials, Manufacturing & Transportation

A BAKER MCKENZIE SECTOR REPORT

Deal activity to rise amid industry disruption, consolidation and the pursuit of new technology

After a dip in M&A transactions this year, we forecast deal activity in the IMT sector to rebound in 2018, with global M&A rising to US$531.4 billion, up from US$483 billion in 2017. For IPOs, we forecast an even more active year, with transaction values rising to US$55.9 billion, up from US$43.8 billion in 2017.

The rise of emerging technology and the easing of key economic risks and political uncertainty that cooled dealmaking in 2017 will likely fuel the rebound in M&A activity and push IPO activity higher in 2018, along with deal drivers that vary by subsector.

"A number of IMT companies face disruption by things like digitization and are having to rethink their business models," says Nikolaus Reinhuber, global chair of Baker McKenzie's Industrials, Manufacturing & Transportation Industry Group. "This leads to carve-outs and spinoffs on the one hand, and the need to develop strategies to invest in smaller technology businesses on the other."

The top IMT deals completed in 2017 include Chinese state-owned subway operator Shenzhen Metro Group's purchase of a 29% stake in China Vanke Co, one of the world's largest home builders, in two transactions totaling US$9.7 billion. US heavy equipment maker Deere & Co acquired Germany's Wirtgen Group for US$4.9 billion to expand its road construction operations amid slowing farm equipment sales.

Meanwhile, the industrials sector was the most active by IPO volume in 2017, with 284 listings worth US$43.8 billion. The largest of those transactions was Italian tire maker Pirelli's US$2.8 billion listing in Milan just two years after the company was taken private in a deal involving ChemChina, followed by US industrial machinery maker Gardner Denver Holding's US$950 million listing on the New York Stock Exchange.

"A number of IMT companies face disruption by things like digitization and are having to rethink their business models."

NIKOLAUS REINHUBER

Global Chair, IMT Industry Group
Baker McKenzie

In 2018, we expect the number of these megadeals to rise even further now that volatility in the US stock market has calmed to record lows, concerns about China's economic slowdown have eased, and world trade is accelerating at the fastest rate since 2011.

GLOBAL INDUSTRIALS & UTILITIES M&A (US$B)						
2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
333	557	645	483	531	491	389

GLOBAL INDUSTRIALS & UTILITIES IPOs (US$B)						
2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
35.1	42	20.6	43.8	55.9	54.2	40.7

Source: Oxford Economics

IMT M&A in 2018: Key drivers

In 2018 we forecast that M&A activity in the IMT sector will be highest in Asia Pacific, with transactions totaling US$183.8 billion, followed by North America with US$162.9 billion, Europe with US$154 billion, Latin America with US$27.8 billion, and Africa and the Middle East with US$2.9 billion.

This is in contrast to 2017, when North America topped the list with US$195.6 billion in IMT deals compared to US$149 billion in Asia Pacific, largely because of tighter currency controls the Chinese government imposed in 2016 that reduced outbound investment in the entertainment, leisure and real estate sectors.

"This prevented some almost certain transactions from coming together in the industrials and utilities markets even though strategically, these transactions were in the interest of the Chinese economy," Global IMT Chair Nikolaus Reinhuber says. "Because of this, Chinese bidders lost some credibility with sellers."

Now that the Chinese government has loosened the restrictions, Chinese investors are rebuilding that trust, and IMT deal activity in Asia Pacific is rising. In fact, China's One Belt, One Road initiative to build trade and transport links across Asia and beyond, is likely to accelerate infrastructure spending throughout the region, providing new M&A opportunities for construction companies.

Earlier this year, for example, a consortium of Indonesian and Chinese investors formed a joint venture to build Indonesia's first high-speed railway connecting its capital Jakarta to the textile hub of Bandung. The venture, estimated to cost US$6 billion, marks the first time the Chinese government has allowed a state-owned company to participate in the design and construction of an overseas infrastructure project.

In North America, deal activity in the construction industry is also expected to rise following the enactment of US tax reform, which would lower the corporate tax rate to 20% from 35%, and reduce the pass-through rate, encouraging dealmaking. If President Trump follows through on his campaign pledge to invest US$1 trillion in infrastructure, that could also galvanize deal activity in North America's construction market.

"The underlying fundamentals driving M&A in various IMT subsectors over the past two years probably won't change. Thus the impetus for deals is likely to continue."

MICHAEL WONG

Corporate Partner, Baker McKenzie

Within other IMT subsectors, consolidation is driving M&A activity in the aviation market as big enterprises buy smaller players to acquire new technologies. In one of the largest deals in aviation history, US aerospace supplier United Technologies announced in September that it is acquiring avionics and interiors maker Rockwell Collins for US$30 billion, creating one of the world's largest aircraft component manufacturers.

"The underlying fundamentals driving M&A in various IMT subsectors over the past two years probably won't change," says Michael Wong, a corporate partner in Baker McKenzie's Taipei office. "Thus the impetus for deals is likely to continue."

GLOBAL INDUSTRIALS & UTILITIES M&A BY REGION (US$B)

	2017	2018	2019	2020
North America	195.6	162.9	124.8	107.2
Europe	108.6	154.0	132.5	104.4
Asia Pacific	149.0	183.8	195.9	153.1
South America	26.6	27.8	35.2	27.2
Africa & Middle East	2.7	2.9	3.0	1.8

Source: Oxford Economics

IMT IPOs in 2018: Key drivers

The number of IPOs in the IMT sector rose 50% in 2017, and the amount of capital raised grew 16% to US$25.4 billion, driven by Italian tire-maker Pirelli's return to the public market and listings by Gardner Denver Holding and Gestamp Automocion, a Spanish car parts manufacturer.

"There is ongoing appetite among investors for solid, tangible assets and profits often found in industrials and utilities," says Christoph Wolf, a corporate partner in Baker McKenzie's Frankfurt office. "These assets are attractive to investors as it's typically easy to understand their value, and they tend to be profitable."

The renewed focus of industrial conglomerates on their core businesses may also lead to substantial sell-sides and spinoffs, often as IPOs. Royal Philips, a Netherlands-based health technology company, Italian automaker Fiat Chrysler, and German energy groups EON and RWE have all floated major divisions in recent years.

The recent surge in IPO activity, however, has led to high valuations that many buyers feel have become inflated. Still, the availability of cheap financing, investment pressure on financial sponsors with large amounts of dry powder, and a shortage of attractive targets has created a seller's market.

"Because the world economy is in reasonably good shape, it's unlikely that this trend will be reversed in the short term as long as interest rates remain low," Wolf says.

Despite the spike in IPO activity, it's unlikely to catch up with M&A levels until valuations come down.

"This probably depends on how long the bull markets will run as many economists are predicting a major correction in the US market," Corporate Partner Michael Wong says. "If that happens, it may impact the IPO route and put favor on M&A activity."

> "There is ongoing appetite among investors for solid, tangible assets and profits often found in industrials and utilities. It's typically easy to understand their value."
>
> **CHRISTOPH WOLF**
>
> Corporate Partner, Baker McKenzie

The Brexit effect

As Brexit negotiations continue, the UK's pending split with the EU appeared to have little impact on IPO activity in Europe. Although listings were slow the first half of 2017, the pickup in activity in the second half resulted in a year of major growth.

Going into 2017, dealmakers appeared worried about the global economic outlook and the implications of other key elections in Europe following the Brexit vote and the election of President Trump. That apprehension seemed to lift, however, after the French and German elections delivered pro-market, pro-European governments.

"There have been fewer political shocks to the European system this year," says Adam Farlow, head of Baker McKenzie's EMEA Capital Markets Group. "Brexit has had little to no impact on the choice of listing venue, and we continue to see a broadening of geographies in EMEA equity capital markets, with more markets open for business."

In the event of a hard Brexit, which would make it much harder for UK-based IMT companies to export their goods into the EU, experts predict that valuations for UK businesses will decline further.

Beyond 2018

Following a peak in deal activity in 2018, we anticipate that M&A and IPO transactions in the IMT sector will drop slightly in 2019 in line with a larger, worldwide trend of cooling deal activity in developed markets.

As interest rates rise, global trade and investment growth slows, and equity prices correct, we forecast M&A values in the sector to drop to US$491.4 billion in 2019 and US$389 billion in 2020. After reaching a five-year high in 2018, we forecast that IPOs will decline to $54.2 billion in 2019 before falling further to US$40.7 billion in 2020.

— KEY CONTACTS —

Nikolaus Reinhuber
Global Chair, IMT Industry Group
T + 49 69 2 99 08 406
nikolaus.reinhuber@bakermckenzie.com

Christoph Wolf
Corporate Partner
T + 49 69 2 99 08 245
christoph.wolf@bakermckenzie.com

Michael Wong
Corporate Partner
T + 886 2 2715 7246
michael.wong@bakermckenzie.com