M&A IN THE TMT SECTOR

Regulation & deal execution remain key concerns for TMT investors

The trends that made 2016 a near-record year globally for M&A in the TMT sector look set to continue in 2017 – for better or for worse.

The desire for vertical integration and need for new technology looks set to drive considerable cross-border activity around the globe. Serendipity is presenting itself on the back of currency changes such as the Pound Sterling since the Brexit referendum. FTI's Consulting's own research with the global investment community shows that 68% expect to see substantial M&A activity or interest for UK companies as a direct result of the currency sliding to US$1.20.

Research conducted by FTI Consulting with leaders in the TMT Finance sector leading up to the M&A event in London.

However, the impact of regulation – on the ability to do deals as well as on the cost of running the business – remain a key issue for investors.

Deal activity in 2016 gives a good sense of the fundamentals underlying many trends for 2017. According to MergerMarket, TMT organisations completed 3021 deals worth US$698.2 billion last year. This volume was propelled forward by a substantial 683 transactions worth US$295 billion announced in the fourth quarter alone, making it the highest Q4 deal value on record. Big transactions included AT&T's US$105 billion intended acquisition of Time Warner; Qualcomm's US$45 billion purchase of the Netherland's NXP Semiconductors; and CenturyLink's decision to buy Level 3 Communications. All three of those blockbuster deals were announced in October, and the AT&T/Time Warner deal was the largest acquisition in any sector globally for the whole year, according to data from MergerMarket.

Regulatory and political concerns prompted the surge in US deal-making, with all three of those large deals being announced prior to the elections in November. Within TMT, the US recorded its second highest deal value in 2016, with 1,101 deals worth US$362.7 billion.

Europe hots up

Europe was also very active, with 992 deals worth US$ 168.6bn reaching the highest annual value since 2007. This was driven by acquisitions targeting Technology (708 deals, US$ 121.3bn) and Media (199 deals, US$ 29.2bn), up 72.6% and 107.7% by value year-on-year, respectively. Big deals here included 21st Century Fox's intended purchase of the UK's Sky for US$21 billion, and Japanese Softbank purchase of the UK's ARM Holdings, the UK's largest technology company at the time, for US$31 billion. The UK alone had 226 TMT deals worth US$81 billion in 2016 – roughly half of the European total.

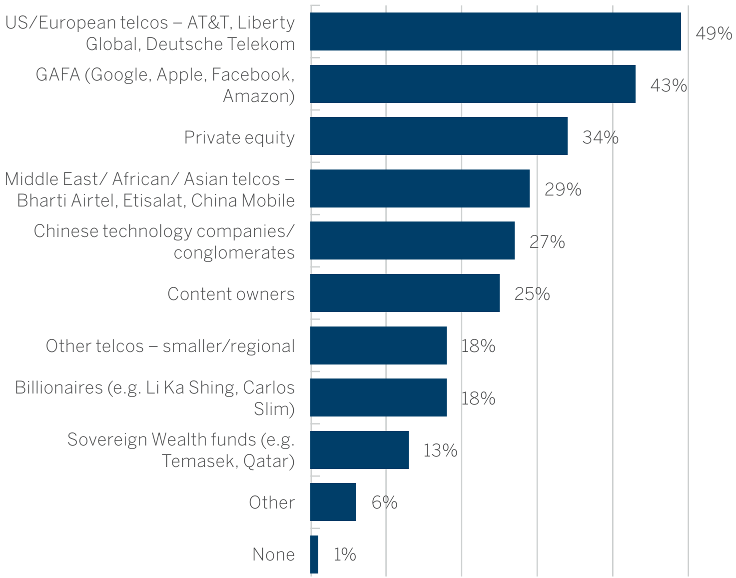
Far East deals to continue

Asia was very busy as well, although mostly with smaller deal sizes. Chinese and Japanese companies were the most active cross-border acquirers. They announced deals for $44.2 billion and $41.6 billion respectively in 2016. The majority of the Chinese purchases were in the US while Japanese companies mostly bought in Europe, including the Japanese Softbank purchase of the UK's ARM Holdings.

Some 41% of TMT Finance respondents believe that cross-border M&A will feature strongly in 2017 – a significant increase over 26% who believed that in 2015. Chinese technology companies or conglomerates are expected to be leading TMT consolidation, according to 27% of respondents. As well, 29% believe that Middle East/African/Asian telcos will have the same role.

Graph 1: Leading Consolidation Activities in 2017

Q. Which of the following do you think will be leading TMT consolidation activities in 2017? (Please select all that apply)



"Chinese M&A in the TMT sector is driven by the need of its industries to acquire new technology," says Michael Knott, Corporate Finance head for TMT in EMEA. "This includes supporting the country's One Belt, One Road initiative. This program seeks to bring together countries along the path of the original Silk Road into a cohesive economic area, by investing in – among other things – infrastructure. We expect China's fast-paced acquisition of overseas technology companies to continue."

The shoe can also be worn on the other foot. Twenty percent of those asked said they saw opportunities for TMT expansion in China (up five percentage points since 2015), and a chunky 37% said they saw similar opportunity across the Asia-Pacific region.

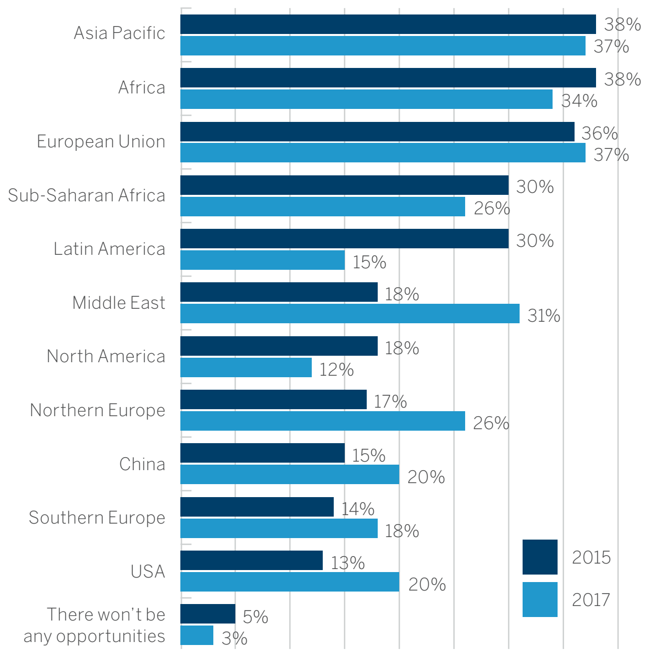
A Brexit bump?

Opportunities for TMT expansion are strong in other regions too. The European Union tied Asia-Pacific, with 37% of respondents saying they saw possibilities there. The perception of opportunity jumped considerably in Northern Europe, with 26% seeing expansion opportunities compared with 17% in 2015. "The result for Northern Europe could be driven by possibilities that may exist post-Brexit," says Charles Palmer, Global Head of TMT in Strategic Communications.

TMT expansion positivity also leapt for the US, rising to 20% from 13% two years ago. Says Palmer, "We expect further consolidation in telecoms and media; vertical integration of content providers; and strategic acquisition of fintech and other high tech companies. The Trump White House is also perceived to be less focused on the regulatory agenda for TMT."

Graph 2: Expansion Opportunities

Q. Where do you see opportunity for TMT expansion for organisations like yours or your clients (whether you presently operate there or not)? (Please select all that apply)

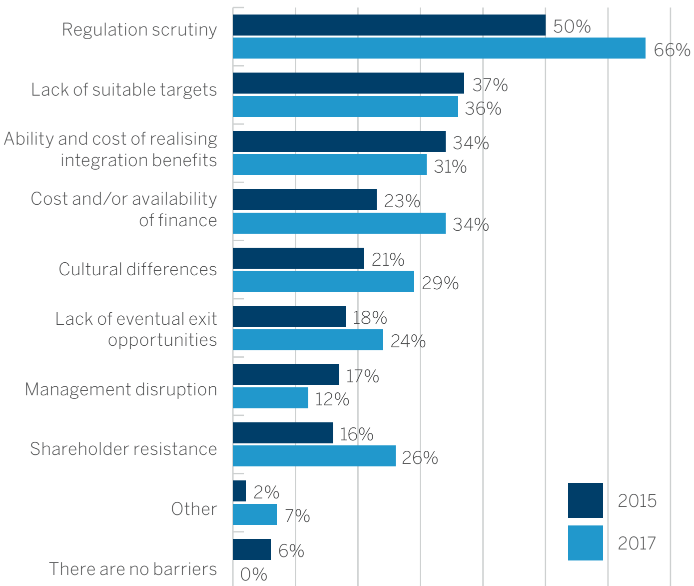


Stable and predictable regulation remains essential

In spite of the expected relaxation in regulation following the Republican victory in the 2016 US elections, two thirds of respondents said that they expected regulatory scrutiny to be a barrier to doing more TMT M&A around the world – up from 50% in 2015. More broadly, regulatory stability and predictability remains a concern; some 63% said that a stable and regulatory and political environment is particularly important when choosing an international location or organisation for strategic investment/expansion. This is an increase from 51% in 2015. Encouragingly, the proposed changes to the European regulatory framework, published in September 2016, recognise the need for lighter touch economic regulation of non-vertically integrated and co-investment business models, particularly in context of superfast broadband deployments. However, the specifics and timing of these changes remain uncertain, and in the meantime data protection regulation and competition authority scrutiny of industry consolidation are both intensifying.

Graph 3: Barriers to TMT M&A

Q. What are the barriers to doing more TMT M&A? (Please select all that apply)



Regulatory issues were also a determining factor in price, and whether or not a deal went ahead, for the deals that respondent organisations engaged in during 2016 for 27% -- up from 14% in 2015. As well, 51% of those who answered said regulation either "significantly" or "totally" reduces profits in the sector – up from 45% in 2015.

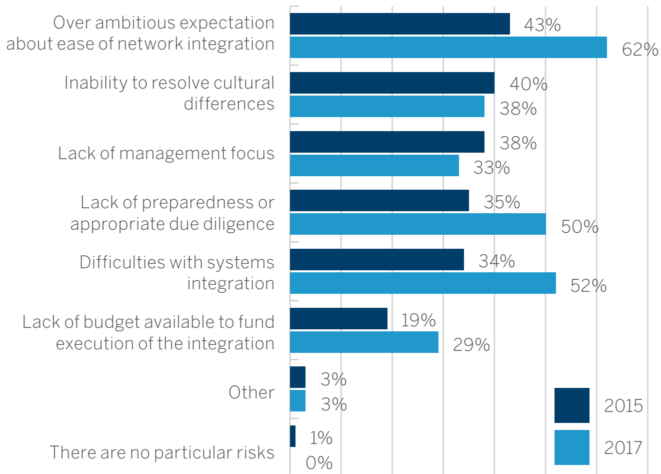
The tide of regulation has been rising in the TMT sector over the past few years, both under the Obama White House and within the European Union. New regulations like the EU's General Data Protection Regulation raise costs significantly. A 'big is bad' mentality has also applied to competition issues within M&A on both sides of the Pond, and changes in the US regulatory regime are to be expected. Meanwhile, Brexit is also likely to impact TMT regulation in the UK.

Value victim of key risks

There is evidence that TMT organisations are beginning to be more cautious about the acquisitions they make for other reasons besides regulation, perhaps reflecting some of the inherent difficulties of cross-border acquisitions. The top key risks in realising a successful TMT integration include 62% who cited "over-ambitious expectation about ease of network integration" – up from 43% in 2015. The second highest was "difficulties with systems integration," selected by 52% of respondents, a rise of 18 percentage points over 2015. In third place was "lack of preparedness or appropriate due diligence", chosen by 50%, an increase of 15 percentage points from two years ago.

Graph 4: Risks in Successful TMT Integration

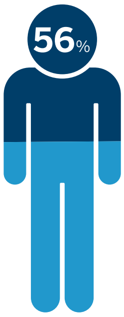
Q. What are the key risks in realising a successful TMT integration? (Please select all that apply)



"The skill set in validating an acquisition can be focused on finance and legal," says Dan Healy, Head of Research at FTI Consulting. "Organisations need to counter balance this with migration and transformation specialists, as well as detailed sales and tech due diligence."

Healy adds, "One of the most interesting findings is that 29% see cultural differences as a barrier to doing more TMT M&A – up eight percentage points from 2015."

66% believe regulatory scrutiny is a barrier to doing more TMT M&A.



56% say content/ distribution convergence will feature strongly in 2017 M&A.

49% say US/European telco consolidation will be a leading TMT M&A trend.

RESEARCH METHODOLOGY

In conjunction with TMT Finance, FTI Consulting's Strategy Consulting & Research team conducted online research with TMT Finance members working in or with the TMT sector in two waves:

2015: n=143 respondents, between 25th Feb to 4th Mar 2015
2017: n=92 respondents, between 2nd to 16th Mar 2017

Further information on the results and methodology can be obtained by emailing dan.healy@fticonsulting.com

Please note that the standard convention for rounding has been applied and consequently some totals do not add up to 100%

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