

# CASS M&A AND PE SOCIETY

## M&A Activity Newsletter

Welcome to the first ever CASS Business School society newsletter composed and published by the Cass M&A and PE Society. This newsletter, constructed by our Junior Analysts, aims to investigate and research a number of transactions uniquely selected by them. In these articles, we will be giving you an insight into some of the most talked-about deals, analyzing key industry trends and parting our opinion on what is likely to happen in the future.

The content of these articles will begin from a qualitative perspective, but will progressively become more technical and focused on financial analysis with each newsletter. With this idea, we hope that you will be able to learn from us more than you can from the Financial Times!



Given that this is our first newsletter, we welcome any feedback that you may have for us! Please be so kind as to email us at: [masociety@cass.city.ac.uk](mailto:masociety@cass.city.ac.uk)

## **Apple acquires Shazam**

One of the most recent and commonly spoken of transactions is Apple's acquisition of Shazam which is about to be completed in the next months. It is already known what the two companies do and how they are related to each other, so a more detailed analysis can be made about the reasons that led Apple to acquire Shazam as opposed to replicating its application and the positive and negative aspects of this deal.

To begin with, Shazam is one of the oldest companies in the world of mobile with strong database and recognition from more than 1 billion users who have downloaded the app. Any effort from Apple to replicate this technology and its tremendous database would take a lot of time with doubtful results. Probably the biggest benefit from Apple's side is that it will harm competitors as they will be blocked from integrating Shazam to their software and advertising their services through this app anymore. Evidence for this is the decision of the former to make the deal known only after Shazam had been in talks with Snapchat and Spotify.

At the moment, Spotify has around 60 million paying users whilst Apple music has only half of that. Cook has announced that Apple's goal is to double the company's services segment within 4 years and the quickest way to do this is by attracting some of Spotify's customers through a better music platform which would have indirect benefits for Apple TV and IOS apps. After the confirmation of the deal, Shazam was integrated to Siri (Apple's technology).

In addition, Shazam had already started the launch of a powerful augmented reality (AR) platform which could support Apple in the completion of its own AR system. It is also worth mentioning that Shazam has been granted more than 200 patents related to its technology and after its acquisition by Apple, the latter can own and utilize these patents in a more profitable way.

On the other hand, some of the disadvantages for this transaction could be the great amount of money that Apple pays for this technology compared to the amount it would spend in order to replicate and develop an equivalent database, but this worry can be hedged by the fact that Shazam's post-money valuation was over \$1 billion. As a result, Apple is going to welcome a

company of that EV in its financial statements in exchange for just \$400 million. Shazam is sure selling for a bargain price!

More precisely, the reason for such a low acquisition price is the low potential of Shazam for long-term development and the sheer numbers of only \$54 million in revenues in 2016. Unfortunately, Shazam was not very profitable then, but actually incurred \$5.3 million of losses in 2016 which is significantly less than those of previous fiscal years. This improvement was crucial in making Shazam a good acquisition target this year, especially when accompanied with the shareholder's realization of poor future performance under the existing technology and operating activities, making it willing to accept a noticeable discount on its EV. Calculating a multiple based on its revenues, Shazam gives its shares a valuation metric of over 7.5x, taking into consideration that the EV is captured as well as the \$400 million instead of the one billion dollars initially estimated. Also estimating the ratios of RoE and RoA, these numbers are negative as a result of negative profit while the leverage appears quite high with \$143.5 million to represent only the amount raised by venture capital firms.

Overall, it can be inferred that Apple's decision to acquire Shazam could be proved highly beneficial for its operations and be helped in the development of a more sophisticated technology like AR while fighting the competition at the same time.

- By Filippos Exarchopoulos.

## **Disney acquires 21st Century Fox**

Disney, the world's largest media company, completed the acquisition of yet another famous entertainment company—21 Century Fox, with nearly \$66 billion. According to FT, this acquisition includes 39 percent stake in Sky, the pan-European broadcaster, and the 20th Century Fox movie studio.

Mickey Mouse should be the most popular original cartoon actor from Disney, which is the basement of future development in film entertainment. In 2006, Disney purchased the Pixar studio with \$5.8 billion. The Pixar studio has the most advanced technique in animation, which create lots of famous film series like Monsters, Cars and Toy Story. This transaction makes great profits for Disney. Compared with the income of studio entertainment in 2005, which is only \$207 million, the income in the same segment enjoyed an explosive growth in following two years (\$729 million and \$1.2 billion respectively). However, in 2008, an unexpected decrease in income forced Disney to think of the solutions. As the result, in 2009, another purchase on Marvel Entertainment was completed with only \$3.8 billion. Ironically, this transaction was not expected an optimistic result by some analysts. With the popularity of Marvel superheroes, such as Iron Man, Captain America, Spiderman, Hulk and Thor, we realised this could be one of the most successful transactions for Disney. In 2014, the net income generated by the the studio has increased to \$1.5 billion and kept growing to \$1.94 billion in 2016.

However, according to FT, at the end of fiscal 2017, cash and equivalents were \$4.02 billion. Total debt stood at \$25.3 billion, about 36% of total capitalization. Compared to a year ago, cash was down and debt was up. In the 2017 financial statement, there is a decreasing trend which is mainly due to the lower income in studio entertainment, especially in theatrical distribution which decreased by 60% in Q4 2017 compared with last quarter. So, this may be the main driver for Disney to acquire 21st Century Fox. Considering Disney's other successful acquisition of Lucasfilm, Pixar, Marvel, this transaction will enforce its absolute power and advantages in film entertainment. Specifically, Disney acquired Lucasfilm five years ago, only The Force Awakens and Rogue delivered more than \$3 billion at the box office and we believe this could establish a strong consolidation for the future; in terms of the acquisition of Marvel helped drive performance of studio of Disney since 2009, which generated an average of \$840 million in each global box.; the acquisition of Pixar, which revitalized Disney's animation business and contributed to more than \$650 million in the average global box office. With the coming films, such as Star War, the last Jedi and the Marvel's Avengers, Disney's managers expect to reverse the decreasing trending in the studio segment.

While DIS reported worse than expected numbers, we believe that DIS is poised to report strong results in FY18 on the back of its upcoming content. Disney's expected growth in 2018 is suppressed by following factors. First, the consolidation of BAMTech and its ongoing investment in the business. We are also looking forward to the ESPN streaming service launch and whether that will help soothe worries about ESPN numbers. As such, we continue to be positive about DIS and believe that it remains a sound investment.

- By Fu Jenhi and Mengxi Li.

## **The Weinstein Company**

The Weinstein Company's Doubtful Future: Bankruptcy or Sale

"The Weinstein Company is not exploring a sale or shutting down", says Bob Weinstein. And it is said that The Weinstein Company, as the distributor, was quite optimistic about the release of Paddington 2 given the great performance of its predecessor. However, with the producers trying to keep Paddington 2 away from the impacts of The Weinstein Company and the fact that The Weinstein Company is in need of cash urgently, Warner Bros took over the distribution. The cash that The Weinstein Company got from this distribution rights sale gave it some time to take a breath before it finally reaches the verge of bankruptcy. Nonetheless, the future of this academy awards winning Indie Company is not promising.

If you ever pay attention to the Hollywood news recently, The Weinstein Company will not sound like a stranger to you. Behind it are the co-founders, notorious Harvey Weinstein and his younger brother Bob. The company is considering selling itself for a capital infusion, just when Harvey Weinstein's scandals hit headlines all over the world. Harvey Weinstein's sexual allegations spanned decades, over continents. Apparently, should a thorough internal investigation be conducted, it will be costly. The whole incident itself could drag the company down terribly, let

alone the costs associated with it. It is reported that the settlement fees will range somewhere between \$20 million and \$40 million. So why has The Weinstein Company picked the worst timing, knowing that a sale now would not benefit themselves, if not undermine their interests at all?

Although The Weinstein Company still have some projects ready in hands, in the long run, its potential for growth doesn't seem attractive. The Weinstein Company has already found it difficult competing with companies like Amazon and Netflix that invested heavily in films and video contents. Besides, the field of independent movies production is increasingly crowded. Notwithstanding the fact that Harvey was kicked out of the company, he still manages to hold 23% of the equity in the company. With its reputation already damaged, it's only harder for The Weinstein Company to survive in this talent and relationship-driven business and attract talents afterwards. It doesn't seem realistic to expect The Weinstein Company to recover from this big strike like a rising phoenix and realize lucrative gains in a sale. And the sale will most likely be an asset-based one, taking account of its work-in-progress inventory, long-term contracts, etc. Actually, Colony Capital expressed its interest and reached out to The Weinstein Company but only found out the assets were not as valuable as they thought. Ironically, after Weinstein brothers sold Miramax which was the first company they founded to Disney and wanted it back so desperately, it was Colony Capital that outbid them. But years later, Colony could have been their saviour.

The Weinstein Company has been experiencing financial difficulties even before the scandals and this is in fact not the first time they have ever considered a sale or divestment, which can also explain why it needs cash infusion right now. However, given the current situation, raising money could be quite expensive and it is highly likely that they cannot attract high-profile projects in the near future. While The Weinstein Company was still a well-known brand, it tried to sell its TV division worth between \$400 million and \$500 million for up to \$950 million, which obviously, was not materialized in the end. But still, a decent price based on assets for a deal can be projected provided that The Weinstein Company remains in the industry over a decade and is associated with titles like "The King's Speech", "Django Unchained", "The Artist", and "Project

Runway". However, those assets are heavily leveraged and borrowed against many times. In 2010, The Weinstein Company finalized a \$450 million debt-restructuring with Assured Guaranty Ltd. And, Goldman Sachs, and the latter sold it to AMC Networks later. The rights to hundreds of movies and its archives will be reverted to The Weinstein Company only after it pays off the debt, which means The Weinstein Company cannot rely on cash flows from these films being replayed like other studios.

What's worse, on November, AI International Holdings, part of investor Len Blavatnik's empire, filed a lawsuit, claiming that The Weinstein Company had defaulted on a \$45 million loan which in the end, Harvey Weinstein signed a guarantee for. It entitled Len Blavatnik to go after Harvey's personal assets.

Under investigation into the sexual harassment, it may take time for The Weinstein Company to find another potential bidder. The problems are, will the buyers proceed knowing that Harvey Weinstein still holds certain shares of the company. Is Harvey Weinstein willing to give up his equity at this point? On the other hand, he surely wants the company to get through this life or death period smoothly. But knowing he is the detriment of the company, he could be faced with a tough dilemma right now.

- By Yeting Huan.

## **NPower and SSE merge energy retail business - Split decision or a strategic move?**

The UK gas and electricity market is dominated by six players; however, the latest move by SSE and NPower to spinoff and merge their retail business led to a major reshuffle. Once the new firm starts operations, it will be catapulted to second place supplying 12.7 million customers, just short of British Gas' 13.7 million.

NPower, bought by the German utility RWE in 2002, was transferred to Innogy in 2016, as RWE spun off its renewable energy generation, energy distribution and retail division in the new company while keeping the more carbon-intensive assets, such as lignite-fuelled power stations, under its umbrella. SSE, the product of several M&A deals made around the turn of the millennium, shares a similar market portfolio with Innogy, as it is the biggest renewable energy generator in the UK, while also being involved in the energy retail and distribution business.

SSE's hand seems to have been forced by the government's plan to introduce a price-cap on energy prices aimed at ending standard-variable tariffs, accounting for 91% of their customers, which have been the firms' high-cost – low-value offering in which customers are placed in automatically. While SSE has been sweating about the government's proposal, NPower hasn't been doing too rosy either, with an operating loss of £90 million last year alone and close to 80,000 customers turning their backs on the German subsidiary. The more pressing reasons for the move to merge therefore appear to be twofold: separate the retail business from the more profitable energy generation one, as well as improve the competitiveness of the new retail company by incorporating efficiencies and decreasing costs in the new market environment brought about by the proposed introduction of the price-cap. Changes in the financials can be seen when forecasting the balance sheet, with NPower and SSE aiming to translate abilities of CapEx savings and cost efficiencies into the combined firm, amounting to a taxed and capitalised £700 million.



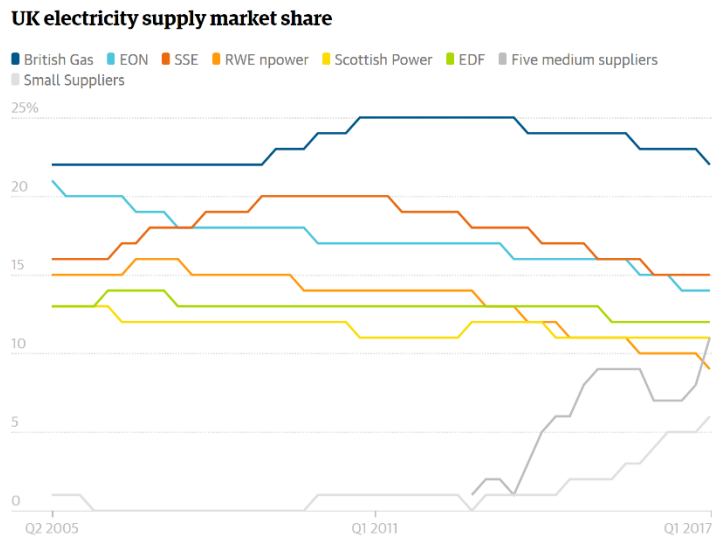


Figure 1 - Data from Ofgem (March 2017)

Another notable development is the change of market share since 2012, with the Big Six' gradually declining while medium and small suppliers, usually composed of cheaper and greener services, have been gaining strength, now amounting to 20% market share up from 1% just a decade ago. The weakness of the Big Six, now the Big Five, can be further underlined by the result of an opinion poll indicating that half of their customers are considering a change; in the month of October 2017, 600,000 customers switched suppliers (an increase of 10% MoM) with a third choosing small suppliers. It is therefore clear that the business model of the competing small firms is becoming increasingly effective, with the green energy – fixed price contract being a more attractive combination to lure in new customers. The new company already has the potential to provide renewable energy, due to the massive involvement of both its parents in green energy generation; however, in order to provide competitive fixed-price contracts, it should be more involved in the energy futures markets, so as to lock in its power purchase price and be able to satisfy the demand of fix-price contracts of households. Its size and its customer base will help it in the price negotiation of future power contracts, therefore giving it the potential of providing extremely competitive deals on the energy retail market.

Considering that SSE will own 65.6% of the shares of the new company, and that Innogy has committed to keeping its shares for 6 months, it appears that the German utility is planning to disentangle itself from the challenging UK energy market, while giving the new firm lobbying

power so as to be able to enter, alongside its competitors, into talks with the government to find middle-ground on the standard-variable tariff affaire.

The main players all focused heavily on the short term, which resulted in them feeling nervous about the changing regulations. For the road ahead, the combined company has to focus on regaining customers' trust with more competitive prices and a wider array of deals such as fix price contracts, as well as shifting their strategy towards a more long-term perspective.

- By Giovanni Curci and Kristof Seres

## **Gazing West**

With a new year afoot, it seems to be a good time for retrospection and to ponder what the future holds for M&A deals ahead. Looking back at the record level of China merger and acquisition activity in 2016, an activity reasonably sustained for certain sectors in 2017. Amounting to \$158.1 billion in foreign mergers and acquisitions despite a 30% decline in comparison with 2016. We now start to contemplate how this might not have been an isolated spike but rather a new norm setting in.

Earlier in July of this year, a Chinese private equity consortium scored the winning bid of \$11.6 billion for Singapore listed Global Logistic Properties, the largest warehouse operator in Asia engaged in the provision of logistics facilities and services, making it de facto Asia's largest private equity buyout.

The acquisition represented a unique opportunity for the consortium to invest in a corporation with a leading platform and expand its leadership position in the modern logistics market space. The privatization was approved on November 30<sup>th</sup> with an overwhelming shareholder support, aligned with the generous premium of 8% over the all-time high closing price of the shares on November 15<sup>th</sup>, 2013 (\$3.38 in cash).

Excitingly, the just-acquired company announced on October 2<sup>nd</sup> having agreed to acquire Gazeley Limited from Brookfield Property Partners L.P. and Brookfield Asset Management Inc. for a consideration of approximately \$2.80 billion. Gazeley, the UK-based company, develops, owns and operates logistics warehouses and distribution parks. Arguably a well-thought acquirement as it provides GLP with Gazeley's imposing assets in Europe which include a 32 million square feet portfolio which is spread on Europe's key logistics markets, namely the UK (57%), Germany (25%), France (14%) and the Netherlands (4%). The deal embodies GLP's first steps into Europe and success in underscoring consolidation in its core business. The acquisition provides a primary operational and development platform for GLP in Europe since it intends to retain Gazeley's current experienced local team and brand.

Gazeley, with properties in the four strongest logistics markets in Europe, has acquired leading capabilities across the entire value chain including Investment, Development, Asset Management and Leasing. Noticeably, this business model is really similar to that of GLP; while the operation is the foundation of its business model it generates significant value through development to meet market demand and serve customer's needs. GLP also leverages its fund management platform to recycle capital from mature, stabilized properties and uses the proceeds to fund new developments.

This also seems aligned with the precedent successful market penetrations, such as the acquisition of 13 million square feet of assets in the main logistics markets of Sao Paulo and Rio de Janeiro for \$1.45 billion in 2014 and the acquisition of two US portfolios for \$13 billion in 2015. By achieving dominant market positions in China, Japan, US and Brazil, the coverage of GLP's platform generates a powerful "Network Effect", which leads to worthy visibility on demand, and strong customer retention.

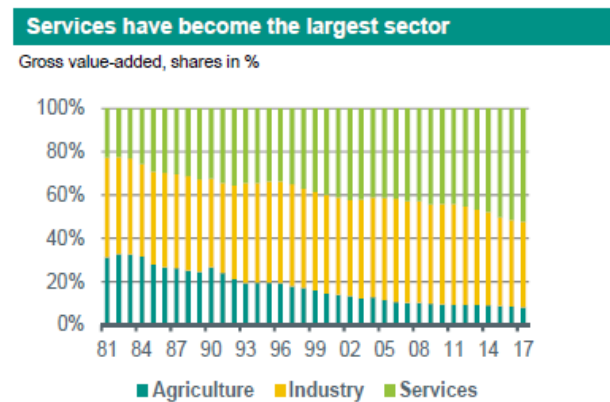
The network effect occurs because the value of GLP's service increases for both new and existing users. Gazeley's asset and products complement GLP existing products and assets, thereby creating synergies.

We can expect more similar acquisitions in order to either reinforce or diversify their portfolios to maintain their edge over the competition.

### Chinese Companies' Deal Drivers

Chinese companies (or consortiums) usually target overseas companies to diversify their assets, while state-owned or large companies see the opportunity to acquire technology or to establish a global presence in strategic activities.

This naturally follows China's fundamental transformation. The shift from an export and public investment model to a consumption one.



The transformation involves the emphasis on high-tech, strategic new industries and services.

Source: EIU

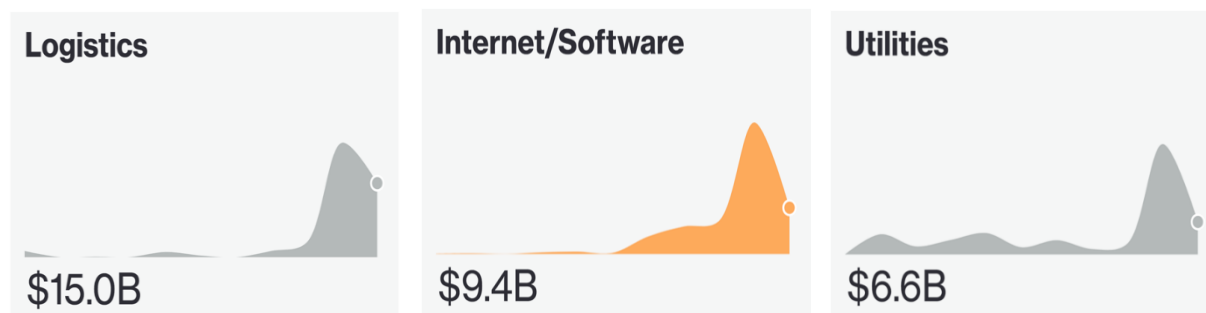
China's two decades of hasty growth have created a large surplus, and some of that surplus is invested in Europe and the US. Like it was particularly the case for GLP which has achieved highest-ever earnings of \$794 million in 2017 and \$1.8 billion cash profit from asset sales over the last five years. Illustrating China's effort to acquire the brands and technology central to transition to a 'new' economy driven by domestic consumption.

This growth directly stems from China's leadership growth goals (including doubling China's 2010 GDP level by 2020) supported by a special interest on industries such as advanced manufacturing,

services and networked information and digital technology. Where Chinese companies are encouraged to acquire expertise and market access overseas.

It is interesting to note that many of the sectors (including logistics) stated as critical to future growth by the government are already witnessing an increased outbound M&A activity.

To present only a few (Total outbound deal value from 2007 to 2017),



*Source: Bloomberg China Deal Watch*

### **The Dark Side**

At the end of – the record year –2016, Chinese regulators passed laws increasing the inspection of outbound deals to implement stricter rules on any overseas investment above \$10 billion, and on any companies investing more than \$1 billion in noncore businesses. However, strategic acquisitions in nature and within specific industries were still stimulated. The new regulation is expected to be particularly tough on overseas real estate purchases.

This uncertainty might have prompted GLP’s acquisition of Gazeley in Europe to capitalize on a rather short opportunity window.

Intriguingly enough, China’s economy remains much less open to overseas direct investors — particularly in M&A — than EU and the US are to their Chinese counterpart.

Hopefully, governments and businesses start to watch beyond deals data and realise how the risk to US and EU companies, like the leading European actor of prime logistics real estate Gazeley,

comes not only from the expanding technological disruptions but also from the competitive risks of the pace and scale of the transformations underway in China.

There are already signs of a shift in the balance of power. It is likely that, at current rates of growth, China by 2026 will surpass the US in terms of GDP.

The European Commission is currently crafting new laws to protect the EU's most strategic companies from Chinese takeovers, especially if the Chinese offeror is backed by subsidies, or if it is making the acquisition based on China's political agenda.

Similarly, many Chinese investments are subject to review by the Committee on Foreign Investment (CFIUS), which defines whether a deal with an alien corporation, especially government-owned ones, raise national security issues. While China only accounts for a few percent of these investments in the US, it comprises nearly a quarter of the CFIUS cases.

These sources of tension, if not balanced by skilful diplomacy, could exasperate geopolitical competition as China slowly dislodges the US as the world's most powerful nation. This deeply contrasts with the 'America first, America first' of the Trump administration. 2018 will certainly be an eventful year...

- by Charles-Anthony Heleine