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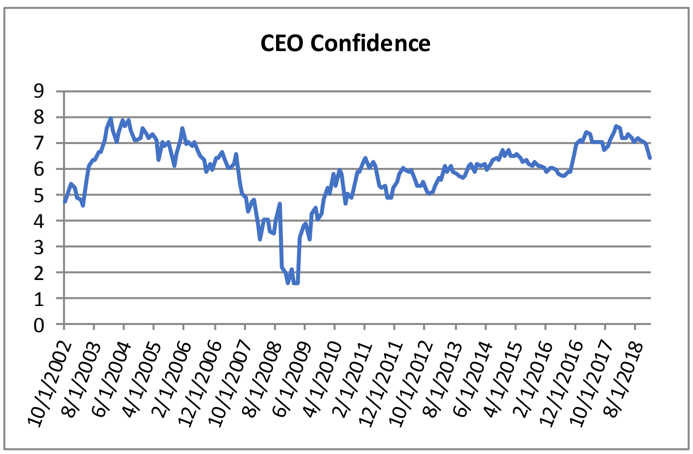
The Art of the Deal—Update
How M&A Fared in 2018

Harris Arch, CFA, Portfolio Manager, Merger Arbitrage & Senior Analyst, Global Equities
Dan Moore, CFA, Senior Credit Analyst, Fixed Income

In early 2018, we penned a piece, "The Art of the Deal," which generated quite a few investor questions. As the year progressed, many of the themes included in the piece played out, some in unexpected ways.

Economic Strength Drives M&A Volume

2018 proved to be a healthy year for M&A activity. In the US, deal value was comparable to robust activity in 2017; however, the number of transactions was about 6% higher. In our view, the economic backdrop coupled with corporate management confidence conspired to drive M&A activity to levels that were above the historical average. While executive confidence did weaken toward the end 2018, we expect that may have been driven by the Q4 equity decline.



From 10/1/2002 – 12/31/2018
Source: Chief Executive Magazine, Bloomberg

Regulatory Headwinds Persist

As we covered in the original piece, the AT&T/Time Warner merger did prove to be a significant milestone for the merger market. The unexpected DOJ lawsuit was defeated in court proceedings. This victory opened the door for multiple subsequent large-cap mergers, such as CVS/Aetna and Express Scripts/Cigna, to close with much less aggressive resistance from the DOJ and FTC. Unfortunately, cross border deals did not fare so well. Deals requiring Chinese approval were often delayed and even abandoned, such as Qualcomm/NXPI, as the M&A process became entangled in broader political trade discussions.

2018 Comes to a Close Beckoning 2019

In 2018, the M&A market faced headwinds stemming from trade, political tensions, and potentially increased cost of borrowing. Still, deal flow remained strong, driven by CEO confidence and a strong economic reality. 2019 greeted us with a partial US government shutdown, which slowed the regulatory approval process. While this has lengthened deal closing time estimates and possibly dampened some activity, deals are still being announced and closing. As mentioned above, regulatory concerns are certainly still at the forefront with cross border deals being potentially fraught with issues. Each breaking news headline can seem to drive speculation about the inner workings of trade talks and how it might affect merger activity. (Well, at least for arbs that is.)

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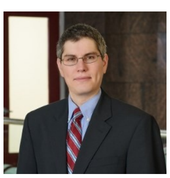
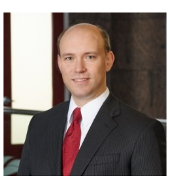
We continue to believe that it makes sense to demand a higher spread for deals with these types of exposure. In our opinion, it is not prudent to entirely avoid the deals with these types of risks, but instead, we try to select deals in which the risk is ascertainable, and appropriately compensated. We expect deal flow to moderate in 2019 as it did in 2018. However, we expect the number and size of deals to be sufficient for our strategy's needs. As in 2018, economic indicators year to date have been relatively strong. Absent the specter of the lack of a trade deal, we would expect corporations to be more optimistic regarding M&A prospects. For one, rates are still relatively low coupled with a slower expected Fed raise schedule and a receptive debt market. Second, CEO confidence is still high, which tends to indicate a willingness to consider merger deals. Finally, equities have rebounded strongly from the swoon in December, driving up the potential value of stock as a deal currency. We remain encouraged that continued economic strength coupled with a supportive debt market will remain a healthy tailwind, driving merger activity.



Harris Arch, CFA, Portfolio Manager and Senior Global Equity Analyst, manages the firm's Merger Arbitrage strategy and focuses on fundamental analysis in the global energy and basic materials sectors. Mr. Arch joined DuPont Capital in 2007 and has been in the investment industry since 2003. He holds a B.S. in Economics, magna cum laude, with concentrations in Finance and Accounting from the Wharton School of the University of Pennsylvania. Mr. Arch is a CFA charterholder and a member of the CFA Society of Philadelphia and the CFA Institute. He serves on the board of the Penn Alumni Club of Delaware.



Dan Moore, CFA, Associate Portfolio Manager and Senior Credit Analyst, assists in managing the firm's Merger Arbitrage strategy in addition to his responsibilities for analysis and trading of high yield and distressed securities as part of DCM's High Yield Strategy. Mr. Moore joined DuPont Capital in 2003 and has worked in the financial services industry since 2000. He holds a B.A. in Accounting from Washington and Jefferson College and an M.B.A. from Drexel University. Mr. Moore is a CFA charterholder and a member of the CFA Society of Philadelphia and the CFA Institute.