GLOBAL DEALMAKING: REVIEW & OUTLOOK

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While U.S.-based mergers and acquisitions activity remains spirited and robust, especially among strategic acquirers, much of European M&A lags far behind, and Asia remains spotty. Expect some vigorous catch-up, with American companies in the mix for offshore acquisitions. That’s one conclusion that a group of experts made during a recent roundtable, Global Dealmaking: Review and Outlook. The Deal and Intralinks Dealspace co-produced the Webcast.

Panelists included Jim Lawson, chairman and managing director of investment bank Lincoln International; Thomas Greenberg, a partner in the M&A group at law firm Skadden, Arps, Slate, Meagher & Flom LLP, and Francis X. Gallagher, senior portfolio manager at Visium Asset Management. Matthew Porzio, vice president of M&A solutions at Intralinks Dealspace served as moderator.

“Historically, Europe has accounted for 30% to 35% of global M&A volume,” Gallagher said. But in the aftermath of the global financial crisis, even as American M&A rebounded, European activity stalled. The EU has battled debt crises on several fronts for years. Gallagher said he believes European M&A should return to historical norms. “I think we’re in the process of seeing that unfold now,” he said.

The complexion of Asian M&A will change as well, panelists said. With China’s economic growth slowing somewhat, the motivation for M&A is shifting, Lawson said. “People were trying to buy into China in order to establish a position there and now,” he said. “Now, there’s going to be a consolidation within industries.”

India-based M&A should accelerate alongside its economy as well. “Investor confidence is up in making investments in India,” Greenberg said. “There’s going to be a lot more acquisition activity into India because it is going to be the fastest growing major country in the world for the foreseeable future,” Lawson added.

On the other side of the spectrum is Russia where cross-border activity has been “really shut down,” Lawson said, although, he pointed out, Russian domestic M&A remains active, and some Chinese and Indian buyers are attempting to take advantage of a lack of Western activity and looking around in Russia.

Brazil M&A “is going to be very selective,” he added, citing healthcare as an exception to a general decline in activity. Brazil has been hard hit by a collapse in commodity and energy prices.

Benefiting from a strong U.S. dollar, low interest rates and hefty cash reserves, American companies should be active in the acquisition fray in Europe and Asia. Large American companies “are looking to invest in overseas developed markets and in emerging markets,” Gallagher said. “They still very much look at that as a way for them to grow, and I think they’ll use M&A strategies opportunistic to do that.”

There are, to be sure, also challenges, especially for American acquirers, even in fast-growing emerging markets. Compliance-related risks in emerging markets remain problematic, and potential buyers must focus on due diligence so they don’t run afoul of the Foreign Corrupt Practices Act, Greenberg pointed out.

With a lack of sophisticated financial managers in the developing world, “financial operations and reporting that you get out of midsized companies in developing countries is just far different than what you get in the U.S. and what we’re used to here,” Lawson added.

Even in Europe, the prospects of heightened deal activity vary by country. Lawson cited Britain as especially strong and Germany, where, he said, Chinese and Japanese companies are trolling the country for technology. Spain is a “turnaround” opportunity. Add to that the Benelux countries of Belgium, the Netherlands and Luxembourg, Greenberg said. “We’re seeing the confidence return in European companies,” he said, “and hopefully the M&A will follow from that.”

Panelists cautioned, however, that European regulators could put a damper on some deals. A new EU competition commissioner was appointed at the end of last year. To date, no deals have been blocked. “But clearly there is an expectation that enforcement in the EU will continue to be aggressive on deals,” Greenberg said.

America, meanwhile, remains the center of M&A activity worldwide and will continue to be so. “U.S. companies have grown their revenues, have grown their earnings, and grown their cash flow at a pretty robust pace,” Gallagher explained. “They’ve generated a lot of cash, but because of slack demand, they’ve been reluctant to make investments in plant and equipment.”

What to do with the cash when interest rates are close to zero? “They either return [the cash] to shareholders or they deploy it in M&A,” Gallagher explained. “A slow, steady growth economy is actually the most ideal environment for doing M&A.”

On this acquisition front, corporate acquirers aren’t limited to American companies, Lawson emphasized. “You’re going to see an increase in the number of strategic buyers from Europe and China and India” looking for acquisitions in the U.S., he said. “The optimism factor that affects strategies is coming back outside the U.S.”

An economic slowdown in China is beginning to finally motivate Chinese buyers.
to look toward outbound M&A, Lawson added. “No longer do they say, ‘well, we’re the fastest economy, the best economy in the world,’” he said. “You are seeing some Chinese buyers come to play, and when they come to play in force, there’s a lot of money there.”

Panelists agreed that because of opportunities to cut costs through merged synergies, corporate acquirers continue to hold the upper hand in competition with private equity. “The strategic buyers have a real advantage over financial buyers that I don’t see them really relinquishing until this M&A up-cycle ends,” Gallagher said.

Higher valuations make this competitive M&A market even more problematic for private equity, Greenberg said, despite PE sitting on a collective pool of about $450 billion in investible funds. “It’s becoming harder and harder for them to find investments that would satisfy those minimum return thresholds,” he said. “It’s a tough environment, but I think that the private equity firms will be more focused and opportunistic buying maybe assets that haven’t attracted as much strategic interest and been [as much a] part of a competitive process.”

That, Lawson said, can include the middle market, where there’s now a preference for private equity because PE often offers existing management minority equity interest. “All things being equal, the management team’s lobbying for that PE buyer,” he said.

Lawson identified acquisitions resulting from spinoffs and restructured companies through activist pressure as one area of PE activity.

The panelists agreed that activist investors, holding something like $130 billion in funds, are a huge influence on corporate behavior. “I don’t think there’s any company that’s completely immune to the possibility of an activist attack or approach,” Greenberg said.

That pressure affects mergers and acquisitions. “Activism has had an impact on M&A as companies are restructuring,” Greenberg explained. “They’re spinning off divisions. They’re selling off noncore assets partially in response to or in anticipation of activist approaches, and it shows no signs of slowing down.”

Europe and the developed countries in Asia have so far largely escaped activist pressure, but that may well change, opening up more fronts for activism, Gallagher said.

Within U.S.-based M&A, healthcare has been especially active for the past few years and will continue to be so, panelists said they believe. According to Gallagher, a first consolidation phase was centered on hospital management. Now, he said, there’s talk about the merger of managed care companies. Pharmaceutical distribution and pharmacy benefit management companies continue to consolidate. And “in the pharmaceutical and the biotech area, it’s almost a free-for-all as far as activity goes.”

Industrial companies are looking to M&A to acquire technology, Lawson said. So, too, are telecom and media companies, Greenberg added.

America’s M&A landscape isn’t universally green. With a collapse in oil prices has come a halt in energy-related M&A. “It’s going to be some time before we see deal activity,” Gallagher said. Many of these companies base their business model on sale price and production volumes, so “they’re really focused internally on their own operations to make sure that their costs are in the right place, that their balance sheet is in good shape rather than M&A,” he said.

Overall, however, the U.S. economy is chugging along just fine, and that will have a positive effect on dealmaking. Lawson subscribes to the view that the U.S. will continue to have reasonable economic expansion and a buoyant M&A environment. “That stability will help with the rest of the world in terms of a global increase in M&A,” he said.