M&A Activity Jumps to Levels Unseen Since Before Global Financial Crisis

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Contributing Partner

Thomas H. Kennedy
New York

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

Global M&A activity jumped in 2014, with over 40,000 tracked transactions totaling approximately $3.5 trillion in value.[1] This represents the biggest year for M&A since 2007, the last year before the impact of the global financial crisis was fully felt.

Favorable conditions, such as higher stock price levels, abundant cash resources and availability of acquisition financing at favorable rates, as well as the desire by corporations to find growth opportunities by means other than organic growth, have existed for several years. In 2014, an improved economic environment, combined with financial market support for well-constructed mergers, relatively low market volatility, the absence of significant political or economic shocks, and the momentum effect of an increasingly active M&A cycle, led increasingly confident boards and management teams to move forward with transactions, some of which were long-contemplated. The number of large transactions increased significantly last year, with 95 announced deals over $5 billion, driving $1.25 trillion (36 percent) of global deal value. That compares to 46 deals worth over $5 billion in 2013, comprising $546 billion (23 percent) of total deal value in 2013.

U.S. activity in 2014 — approximately $1.6 trillion — was up over 50 percent from 2013 levels, comprising approximately $1.3 trillion in domestic transactions and approximately $275 billion in U.S.-targeted cross-border activity. Despite a strong dollar, many European companies (especially German) looked to the United States for favorable acquisition opportunities, and inbound investment into the U.S. increased dramatically. In addition to consolidation activities, many large companies, as part of a continuous emphasis on core strategies, executed large divestitures.

Although many European economies remain sluggish, Europe M&A activity grew to approximately $840 billion-$875 billion, up 50 percent from 2013 and representing almost a quarter of the global transaction volume. (See "The Newfound Attractiveness of European M&A.") Cross-border activity involving Europe was an important driver of the 2014 activity, especially earlier in the year when the so-called "inversion" phenomenon (which involves the merger of a U.S. entity with a foreign entity, with domiciliation of the surviving entity in a lower tax jurisdiction) helped drive transactions, especially in the pharmaceutical industry. Fundamental changes in the approach of various industry participants to research and development and global marketing and distribution were significant factors in the drive to consolidate and were aided by the possibility of effecting more favorable fiscal positioning for these companies. (See "Insights Conversations: Life Sciences.")

Activity in Asia amounted to approximately $780 billion and was in large part due to activity involving Chinese state-owned enterprises, which are engaging in internal restructuring activity and are increasingly driven to pursue strategy (including acquisitions) on a global basis. (See "China M&A: Reform Plan Promotes Mixed Ownership of State-Owned Enterprises.") Asian transactions were focused on the consumer and resource sectors.

Other than health care, sectors that experienced significant activity included energy ($579 billion), in part driven by the ramifications of both fundamental industry transformation and the collapse of oil prices; and telecom/media/entertainment (TME) ($472 billion), where consumer demand for mobile and broadband, the resulting need of carriers for additional capacity, and the challenges of rapid market and technological changes in the converging industry drove transactions, albeit oftentimes subject to the restraining influence of regulatory pressures. (See "Antitrust and Competition: Surveying Global M&A Enforcement Trends.") While M&A activity in the TME sector developed earlier in the U.S. (*e.g.*, Comcast/Time Warner, AT&T/DIRECTV), European activity surged in late 2014 (*e.g.*, BT bid for EE). In addition to transactions classified as TME, other technology M&A soared in 2014. Rapid changes across multiple verticals of the tech sector (*e.g.*, mobile, big data, cloud computing or the “Internet of things”) are driving the strategic imperative for companies to align themselves for perceived future trends. Large companies such as Google, Apple, Yahoo, Facebook and Microsoft continue to be active acquirers, in search of user base, intellectual property and talent; and activity in the smaller end of the market also is robust. Certain industries, such as financial companies, lagged significantly, in large part due to the continued pressures brought by regulators.

Private equity transactions amounted to $562 billion, constituting 21.9 percent of global M&A activity. Much of this volume was driven by exit activity in maturing funds. Private equity transactions involving large public companies were somewhat quiet earlier in 2014, in large part due to the ability of corporate acquirers to outbid for desired strategic assets, although the Petsmart, Tibco, Gates Global and Acosta deals showed the ability to accomplish transactions in appropriate circumstances. Overall, levels of private equity M&A transactions for public companies remain below the levels that prevailed in 2006 and 2007.

Strategic Decisionmaking and Impact of Activism. The impact of activism on M&A is profound — the presence of activism is now viewed as an integral part of the corporate landscape and not a passing fad or cyclical phenomenon — with implications for all aspects of the M&A ecosystem. While the philosophical debate on the value of activism continues in the academic arena, corporate boards and senior management teams recognize the tremendously increased clout of activists — who have somewhere between $100 billion and $200 billion under management and participated in over 350 targeted campaigns in 2014 — and are increasingly willing to listen to their ideas. As importantly, boards are attuned to the desire of institutional shareholders and other investors for corporate focus on shareholder value in the near- to medium-term and are in many instances taking proactive steps to achieve increased value even before or without the public appearance of an activist. Activist activity is increasingly targeted at companies that are not actually lagging in financial results or market performance. In addition to capital allocation decisions, including share buybacks, this has led to a continuing number of spin-offs (over 60 announced in 2014) and divestitures, as well as determinations to sell a company when circumstances warrant. In addition, companies with meaningful portfolios of qualifying property are increasingly looking to use REIT strategies to help unlock value. (See "Unlocking Value Through REIT Spin-Offs.")

Hostile Activity; Deal Jumping and Withdrawn Deals. Six unsolicited bids exceeded $20 billion in 2014, all in the pharma or telecom space. While the original hostile bidder was not ultimately successful in many transactions, the use of aggressive techniques continues to be acceptable in the corporate world. Companies have not hesitated to move aggressively on strategic targets — which may have led to a surge in announced but later withdrawn transactions. The dismantling of corporate defenses as a result of institutional shareholder pressure and the positive attitudes of these investors to favorable bids helped propel such activity. In addition, corporate players will intervene in an announced transaction when a desirable acquisition target is engaging in a transaction (*e.g.*, Hillshire Brands, Chiquita). Finally, 2014 saw the withdrawal or termination of almost $800 billion of transactions — roughly one-fifth of announced transactions. Europe experienced an even higher percentage of withdrawn deals, many involving potential inversions. This is indicative of the challenges to successful execution of a transaction, and, as discussed more below, the need for careful planning and execution.

Sales Processes. Two significant themes were reiterated by Delaware courts in 2014 — the need for careful board involvement in M&A decisionmaking and judicial deference to the business judgment of a fully involved and independent board as to how to maximize value. (See "Fee-Shifting, Financial Advisor Liability Among Likely Delaware Law Issues for 2015.") The first theme was prevalent in the Court of Chancery's decision in *In re Rural Metro Corp. Stockholders Litigation*, where, after trial, the court found a financial advisor liable on an aiding and abetting theory for money damages after ruling that various conflicts of interest existed among the company's management, board and advisers. The case is a stark reminder that attention to conflicts in any transaction is crucial. Both themes were clear in the Delaware Supreme Court's opinion in *C&J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust*, which confirmed that a disinterested and fully informed board need not shop the company to fulfill its duty to seek to maximize value in a change-of-control transaction. Also, in *In re Family Dollar Stores, Inc. Shareholder Litigation*, the Delaware Court of Chancery reconfirmed that in seeking to obtain the highest value reasonably attainable, boards are not limited to reviewing "headline" price, but can look at factors such as likelihood of consummation. These decisions reaffirm the Delaware courts' deference to well-informed, unconflicted boards that seek to maximize stockholder value.

Regulatory/Compliance. Corporate acquirers remain cognizant that regulatory factors in the U.S., the EU and in other major economies (*e.g.*, China, India, Brazil and Canada) remain a significant obstacle to successful execution of transactions. In addition, social and political factors, including employment and labor relations, industrial policy and national security concerns, must be carefully considered in significant transactions, especially cross-border.

Deal Complexity. With the interplay of activist involvement, aggressive strategic competition in the M&A process and global regulatory issues, completing a significant transaction requires extensive planning, clear articulation of strategy at announcement, broad dialogue with affected constituencies, and constant and vigorous attention to execution.

Prospects

Most of the factors that drove M&A activity in 2014, including board confidence and the fundamental need to find growth opportunities in a world where the pace of economic recovery varies significantly from region to region, continue to exist (the surge in inversion transactions being a notable exception). In the absence of a significant change in the geopolitical or economic landscape, we likely will continue to see a favorable environment for M&A transactions, perhaps in a broader range of industry sectors. That said, acquisition multiples are high, and changes in the economic or financial markets, including a cooling of current investor receptivity to transactions, could change the mood.

[1] The statistical data used in this discussion is derived from a variety of sources, including reports from Thomson Reuters, Bloomberg and Dealogic, as well as various major news publications. Definitions and computations may vary across these sources, and the data may not be gathered from definitive year-end reports. In many instances, we have rounded or approximated the data.