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Strategic Imperatives, Market Confidence Drive US M&A

Contributing Partners

Stephen F. Arcano / New York

Thomas H. Kennedy / New York

2017 was another active year for mergers and acquisitions, both in the United States and globally, though the overall dollar volume of deals continued to lag behind 2015's record levels. Global M&A activity was relatively flat compared to 2016; U.S. dollar volumes were slightly down, though the number of deals increased meaningfully. U.S. transaction activity was restrained early in the year, as deal-makers treaded cautiously while assessing the implications of potential changes in policy direction following the 2016 presidential election — market commentators cited potential tax law changes and policy uncertainty as factors holding back deal activity. However, decision-makers seemed to move past these concerns, and transaction volume picked up over the course of the year (notwithstanding a continued lack of clarity throughout most of the year regarding the likelihood or terms of tax reform and questions regarding antitrust policy).

U.S. M&A continued to be driven primarily by strategic transactions as corporations, taking advantage of a relatively benign deal environment, continued to address the need to grow earnings and better position themselves to compete in the global marketplace. In the low-growth environment of recent years, M&A has provided many companies an opportunity to increase earnings at a rate beyond that possible through organic growth alone, and to take advantage of margin expansion opportunities through realization of the synergies and cost savings often available in the transaction context. M&A also has provided an avenue for corporations to augment technological, geographic and product-offering platforms. The combination of stable equity markets, the availability of transaction financing at attractive rates and strong balance sheets helped to provide corporate executives and boards with the confidence to pursue significant, even if not truly transformational, deals in 2017 despite extant uncertainties.

Cash Transactions. Cash acquisitions represented a substantial portion of deals in 2017, although later in the year more transactions included stock consideration, particularly at the higher end of transaction size. For the most part, investors rewarded corporate acquirers executing strategic transactions, particularly where substantial synergies were identified as being available in the near term. Low interest rates for debt financing, coupled with synergies, allowed many cash transactions to be immediately accretive, and while interest rates may rise over time, they continue to be relatively low on a historical basis. Acquisition financing remains available (subject to new limitations on interest deductibility that may be relevant to some purchasers), and the availability of repatriated earnings will likely provide additional cash "firepower" for corporate acquirers. While stock or partial-stock deals may be attractive to the extent acquirers face interest deduction limitations or target boards seek greater participation in transaction upsides for their stockholders, it is likely

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Four Times Square
New York, NY 10036
212.735.3000

that cash transactions will continue to represent a significant portion of activity in the coming year.

Technology and Convergence. Rapid technological change is having a profound impact on a large portion of the economy, with entire industries being reshaped as a result of the disruptive power of new technologies and platforms. A manifestation of this impact has been in the trend toward convergence across a wide range of industries, from financial services to health care to retail, but perhaps most clearly playing out in the technology, media and telecommunications sector. Companies in the media and technology ecosystems are realigning their business models to compete with vertically integrating competitors and large technology platform companies. Facing rapid changes in global consumer preferences, increased utilization of digital distribution channels, the emergence of new hybrid businesses and the implications of the globally networked internet of things, companies in most industries are using M&A to effect expedited change in their business models and product mix.

Unsolicited Activity. Openly "hostile" transactions continued to represent a relatively small portion of total M&A activity in 2017, but these situations constitute only a fraction of unsolicited activity. While there are no reliable statistics to assess the prevalence of transactions involving unsolicited offers that do not become public, anecdotal evidence suggests that an increasing portion of deals are beginning on an unsolicited basis rather than as a result of target-initiated sales processes, often with significant nonpublic pressure. Put another way, in the current market, many targets are "bought, not sold." This is not surprising given the nature of the strategic imperatives driving M&A and mainstream acceptance of hostile M&A as a viable alternative in the right circumstances. As a result, companies will want to be prepared for the possibility of an unsolicited offer from an aggressive suitor.

Activism. A significant feature of the corporate landscape is the continued prevalence of shareholder activism in pursuit of economic platforms. Notwithstanding "passive" institutional investor commentary encouraging corporate managements and boards to pursue long-term decision-making, activist campaigns have continued to have a meaningful impact on corporations' strategic actions, including capital allocation decisions and M&A. A significant number of corporate transactions such as company or business-unit sales, spin-offs and other transactions have occurred following activist involvement in a stock, and activists have at times sought to involve themselves directly in transaction processes. This type of activity seems to have become a permanent part of the corporate landscape and one for which boards and management teams should be prepared, including in the context of reviewing potential strategic initiatives. It is possible that corporate access to additional liquidity arising from the repatriation of offshore cash and lower corporate tax rates may lead to more activist campaigns seeking bigger share repurchases or other capital return to shareholders.

Tax Reform. Uncertainty regarding U.S. tax reform was a major topic in 2017, though much of the uncertainty was eliminated with the adoption of the new Tax Cuts and Jobs Act. The new law is likely to have far-reaching implications for transaction structuring that are not yet fully understood, but overall the reduction of the U.S. corporate tax rate and incentives for U.S. companies to repatriate offshore earnings are likely to be positives for U.S.-targeted M&A. Passage of the tax law should allow parties greater confidence in planning transactions than existed in 2017, notwithstanding questions regarding the details of the law's implementation. (See "US Tax Reform Enacts the Most Comprehensive Changes in Three Decades." For a more detailed look at the new tax law, see our January 18, 2018, client alert "An In-Depth Look at the Impact of US Tax Reform on Mergers and Acquisitions.")

Regulatory Environment. While much of the regulatory agenda of the Trump administration has been generally favorable for business, M&A participants have remained cautious with respect to the development of policy in certain areas affecting M&A activity, including antitrust enforcement and national security review.

In the antitrust area, there seems to be a global trend toward more aggressive review and enforcement, with much of the focus in the U.S. on the government's approach to vertical integration issues and whether this represents a shift. (See "Novel Theories Emerge in Merger Enforcement.") The question of U.S. regulators' approach toward vertical integrations may become more pointed as the convergence trend discussed above plays out. National security reviews also are becoming more complicated on a global basis, with the adoption of new review regimes and expansion of the application of existing regimes to a broader array of transactions slowing or complicating some portion of cross-border deals. U.S. national security review has continued to impose a hurdle for acquisitions by Chinese buyers in many of the industries of interest to such buyers. (See "Reform Proposes Sweeping Changes to CFIUS Reviews.") However, at this time, a fundamental shift in the regulatory review environment in which we are operating does not appear to have occurred. Importantly, the percentage of transactions that are blocked or meaningfully restructured or delayed due to regulatory review and enforcement continues to be low.

Overall, the transactional landscape for 2018 appears very similar to that of 2017: strategic imperatives driving corporations to pursue M&A activity, a benign environment due to stable equity markets and attractive debt financing markets, and regulatory challenges in deal execution that for the most part should be manageable with careful focus on transaction planning and execution. There are headwinds that could restrain deal activity this year: A faster-growing economy may decrease the pressure to "buy" growth; the combination of high asset prices and increasing interest rates may make it more difficult to make the math for acquisitions work; and uncertainty as to the impact of trade policy, geopolitical disputes and other political risks could undercut the confidence necessary to pursue significant M&A.