Skadden

# Stay Calm and Carry On: Strong 2019 US M&A Market Supports Optimism for 2020, Though Headwinds Persist


Partner

**Stephen F. Arcano** / New York

Strategic Advisor to Knowledge Strategy

**Thomas H. Kennedy** / New York

Associate

**Alexander B. Fullman** / New York


M&A professionals greeted 2019 with a note of caution. Following a strong year for M&A in 2018, optimism was tempered by concerns over increased market volatility, trade disputes, rising interest rates and global political uncertainties. As it turned out, we saw significant turbulence in a number of areas in 2019, including trade relations, domestic politics in the U.S. and Europe, and regional flare-ups in the Middle East and Persian Gulf. Notwithstanding this turmoil, deal activity remained resilient, particularly in the United States, facilitated by relatively stable equity markets and available financing. While global transaction volume of approximately $3.3 trillion in 2019 was down slightly from 2018, it nonetheless represents the fourth-largest annual volume on record; and U.S. volume of approximately $1.6 trillion was up slightly from the prior year, according to data from Mergermarket. Companies announced a number of significant deals at the end of the year, and a robust pipeline supports continued, if cautious, optimism for 2020.

Large transactions drove market statistics for 2019. The number of deals valued at greater than $10 billion was up compared to 2018 and represented close to one-third of global activity and approximately 10% of U.S. activity. Average deal size increased to $389 million globally, the second-highest on record, and a record $768 million in the U.S. At the same time, the total number of deals fell both globally (down approximately 5% from 2018) and in the U.S. (down approximately 10%) for the second consecutive year.

Activity in 2019 was again fueled in large part by strategic transactions, as corporations continued to make substantial investments in response to the imperatives of increasing earnings and enhancing competitive platforms and scale. Deal activity was strong across multiple industries, including industrials, pharma/biotech, energy/resources, technology and financial services. Notably, the three leading sectors — industrials, pharma/biotech and energy/resources — accounted for almost half of global deal volume. Private equity activity was again at a healthy level, following a strong 2018, though elevated equity prices and strategic competition for attractive assets tempered the impact of record levels of available capital.

## Selected 2019 Trends

**Strength of US Activity and Decline in Cross-Border Activity.** As the M&A market softened in many geographies, the U.S. stood out as an attractive destination, with activity representing approximately 47% of global M&A — the highest proportion since 2001 — owing to a relatively strong economy and a number of large domestic transactions. Mergers of U.S. corporations represented 15 of the 20 largest deals in 2019. Cross-border activity decreased approximately 6% globally compared to 2018, and consistent with generally strong U.S. activity in 2019, the U.S. accounted for 20% of all cross-border acquirers and 25% of all cross-border targets.

**This article is from Skadden's *2020 Insights*.**




Four Times Square
New York, NY 10036
212.735.3000

**Regulatory Developments.** Over the past several years, national security regulatory concerns have negatively impacted cross-border M&A activity, particularly in the United States with respect to investment in certain industries by Chinese companies and state-controlled investors. The jurisdiction of the Committee on Foreign Investment in the United States was expanded in 2018, and final regulations were adopted in early 2020 requiring mandatory filings for certain foreign investments in businesses involving critical technology, infrastructure or sensitive personal information. These rules, in addition to other factors, have contributed to the chilling effect on Chinese investments, particularly in the U.S. tech sector. At the same time, ongoing tensions in the U.S.-China relationship have continued to limit U.S. companies' appetite for transactions involving significant Chinese assets. Concerns over Chinese investment, again focused on technology and other sensitive industries, also have been exhibited by the U.K. and other European countries. (See "CFIUS' First Full Year Under FIRRMA" and "Conservative Party Win Paves Way for Reforms to UK National Security Reviews.")

On the antitrust front, the Federal Trade Commission (FTC) and Department of Justice (DOJ) continued to pursue vigorous enforcement in 2019, including scrutiny of vertical mergers and transactions where large companies are perceived to be acquiring nascent competitors, especially in the technology industry. This regulatory focus on large tech companies, which is consistent with increased regulatory scrutiny in Europe and the U.K., is in line with growing political focus on the behavior of large technology and health care companies. Consistent with their renewed interest in vertical merger enforcement, in January 2020, the DOJ and FTC jointly issued for comment a draft set of updated Vertical Merger Guidelines, which would provide an updated articulation of the government's current analytic approach to these transactions. The FTC also has shown continued interest in investigating consummated transactions and conducting merger retrospectives to guide future policy. (See "Antitrust Enforcement Centers on Technology Industry.")

While the impact of regulatory developments on overall transaction activity can be difficult to predict given the *sui generis* nature of specific deals, navigating the regulatory and political scrutiny of significant transactions has become more complicated and time-consuming.

**Private Capital.** Financial sponsors continue to play an active role in U.S. and global M&A, with a healthy level of activity in 2019. While global private equity activity was down slightly from 2018, sponsor buyouts represented over one-quarter of total deal activity. In the U.S., buyout levels reached a post-2007 peak, representing almost 15% of U.S. transaction value, according to Mergermarket. Private equity firms face mounting competition from other sources of private capital, including sovereign wealth funds, Canadian pension funds and family offices, which may have different return criteria and longer investment horizons than PE funds. However, private equity activity is poised to remain strong and may benefit if perceived economic headwinds start to affect asset prices.

**Separation Transactions.** Corporations have put substantial effort into optimizing their business models, adding technological, platform and geographic capacity to service their customers. At the same time, both corporations and investors have continued to focus on corporate clarity and fit, with companies separating non-core businesses that may have greater value to others or which may trade with different multiples or other characteristics in the public market. One manifestation of this latter trend is the number of significant spin-offs and reverse Morris trust transactions (involving an agreed acquisition of a distributing or distributed company following a spin-off) in recent years, which was again a notable trend in 2019, with $13.4 billion in volume for spin-off transactions in the U.S., according to Bloomberg Global.

**Activism.** Activist funds continued to have a meaningful impact on corporate strategic activity. Assets under management at activist funds remain high, at approximately $170 billion, according to *Activist Insight*, and increasing professionalization and sophistication, particularly at the larger activist hedge funds, have permitted those firms to have disproportionately loud voices compared to actual share ownership at even the largest companies. Corporate groups (such as Business Roundtable), certain institutional investors and politicians have provided substantial commentary regarding the importance of companies pursuing long-term corporate strategies focused on the needs of employees, communities and other constituencies in addition to shareholders. However, the practical effects of this shifting zeitgeist are unclear, and event-driven activism continues to attract significant shareholder support. The number of activist campaigns in 2019 was down from 2018, by over 10% globally and somewhat less than 10% in North America, according to *Activist Insight*, but there was no dearth of high-profile situations, many of which generated or impacted deal activity. Numerous public campaigns and private engagement efforts sought to pressure corporations to pursue strategic changes, most frequently including board refreshment and M&A initiatives, such as the sale of the company or the sale or spin-off of businesses. Many of these campaigns targeted large companies, with over 20% of activist demands directed at companies with market caps of $10 billion or greater. "Announced deal" activism, in which activist funds seek to renegotiate price or stop a transaction altogether, was pursued at both targets and acquirers.

## Looking Ahead

Notwithstanding the strength of M&A activity at the conclusion of 2019, cautionary signs remain. Significant economic and political uncertainties continue to confront the global community, and at some point the headwinds they generate will likely slow the corporate appetite for merger activity. Apprehension remains over the duration of the economic cycle, trade and tariffs, increased equity market volatility, the direction of interest rates and potential tightening of borrowing conditions. The decline in the number of transactions in 2019 compared with 2017 and 2018 is a concerning sign of the overall strength of the M&A market.

As political criticism of large companies mounts amid growing populist sentiment in many Western nations, and regulatory scrutiny of transactions causes increasing uncertainty as to the timing (and in some cases the ultimate execution) of deals, the perception of political and regulatory risk may restrain the pursuit of some transactions. This may become a cause of particular concern in the U.S., where the 2020 election campaign has featured candidates highlighting proposed changes to antitrust and regulatory policies potentially impacting the financial services, health care and technology sectors. Combined with high asset prices, activist challenges to transactions at both the target and acquirer levels, and concern over timing of the business cycle and a potential recession, transaction parties may tread cautiously.

At the same time, several factors suggest significant M&A activity will continue in the coming year. Most importantly, the strategic need of corporations to grow earnings and optimize business platforms has not abated. Corporate buying power remains high, with access to significant balance sheet cash and the debt financing markets, as well as the ability to use stock as consideration in appropriate circumstances. Finally, private equity buyers and other private capital sources remain anxious to deploy substantial capital and are poised to jump in if asset prices come down. Absent meaningful deterioration in fundamental economic conditions or sustained disruption of access to deal financing, these drivers should continue to support significant transaction levels in the coming year.