Skadden

Will Europe's M&A Boom Survive Stricter Regulation, Shareholder Resistance and COVID?

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Takeaways

- Although deal flow continues to be strong, stricter antitrust and national security reviews may pose obstacles for some mergers.
- Financial sponsors remain very active, and with more corporate divestitures appearing likely, are expected to remain prominent players — but increased public scrutiny and shareholder resistance could prove to be stumbling blocks.
- Measures taken to tame inflation could cool the appetite of some buyers.

European M&A activity surged in 2021, ending fears that a dip during the initial months of the COVID-19 pandemic would be a precursor to a longer slump. Both deal volume and values climbed steeply, powered in no small part by financial sponsors.

But, amid the headline-grabbing figures, challenges emerged that caused some transactions to fall through, and may give dealmakers pause as they look ahead this year.

Changing Regulatory Landscape

Investors and corporations are accustomed to assessing the probability of deals meeting conditions for antitrust and financial services approvals, but the increasingly interventionist approach of regulators, as well as the introduction of new foreign direct investment regimes in Europe, may alter the calculus.

While Nvidia's proposed purchase of U.K. semiconductor maker Arm is still live, it is a recent example of a high-profile transaction that has hit potential stumbling blocks with regulators — in this case, from three jurisdictions. The U.K's Competition and Markets Authority (CMA) announced an in-depth review on both antitrust and national security grounds. The European Commission said it would likewise conduct a detailed antitrust analysis. Meanwhile, in the U.S., the Federal Trade Commission sued to block the takeover, alleging the "combined firm would have the means and incentive to stifle innovative next-generation technologies."

A CMA order to Facebook (now Meta) to sell Giphy after the purchase was complete may also signal a shift in regulators' attitude toward to acquisitions of startup technology companies by large ones. Transactions may no longer be exempt from regulatory review simply because they do not present traditional antitrust concerns, such as significant market overlap. This may be especially true where startups are acquired before growing enough to establish themselves as competitors in the market. In this case, the CMA found that Giphy was considering expanding its advertising services to countries outside the U.S., and the acquisition could potentially remove a competitor to Facebook's own display advertising services in the U.K. Meta has appealed the order. (See "Deal Uncertainty Increases as Merger Control Authorities Gain Discretionary Powers of Review.")

Newly adopted national security review processes in many countries could also pose new obstacles. (See "CFIUS Goes Global: New FDI Review Processes Proliferate, Old Ones Expand.")

Shareholders Not Swayed by Price Alone

In the competitive landscape seen over the last 18 months or so, public company boards have taken a hard-nosed approach, successfully playing bidders off against each other, and forcing them to pay higher multiples for the most sought-after assets. However, in some cases, the high bidder nonetheless failed to secure the target.

For instance, Advent International and GIC came very close to prevailing with their $8 billion proposed buyout of Swedish biotech company Sobi, with approximately 83.7% of shares tendered to an offer representing a 35% premium. But the bidders needed 90% acceptance to allow a compulsory purchase of the remaining shares (known as the "squeeze-out"), and they walked away.

Before recommending a bid, boards have also been required to weigh the increased public scrutiny of deals and — particularly where private equity bidders are involved — stakeholders' concerns about securing a longer-term future for the business.

In the U.K., for example, the proposed takeover of mutually owned life insurer LV by Bain Capital prompted significant pushback from both pro-mutual LV members and politicians, who questioned the rationale for the deal and the choice of Bain. While LV's management argued that Bain's offer was the only option that offered both an "excellent financial outcome" for members and support for investment and employees, critics attacked the plan to demutualize LV. They deemed the offer to members insufficient, questioned the benefits that would be received by management and argued that the deal would allow Bain to extract assets that had been accumulated over years as a mutual insurer. Opponents also sought clarity about why an offer from fellow mutual Royal London was not pursued. Ultimately, only 69% of LV's members who voted at the meeting convened to approve the deal supported it, below the 75% threshold required for the sale to proceed.

These cases notwithstanding, new opportunities also emerged in 2021, in part due to the disruption caused by the pandemic. Corporate boards sought to make their companies more efficient and refocused their strategic priorities, in some cases, pushed by activist shareholders. This led to an increase in carve-out transactions. Private equity featured prominently in auctions for these assets, including the sale of Unilever's global tea business to CVC Capital Partners and the disposal of Lonza's specialty chemicals division to Bain Capital and Cinven. This is likely to continue in 2022.

Environmental, Social and Governance (ESG) Considerations

The pandemic intensified the focus on ESG considerations, with the United Nations Climate Change Conference (COP26) contributing to this in Europe. The preferences of limited partners, consumers and employees for "ESG-positive" companies became an increasingly significant factor in M&A, as it was reported that some sellers saw bidders pull out of potential acquisitions due to ESG concerns. That may lead other sellers to reconsider bringing assets to the market if they have not addressed any ESG concerns.

Conclusion

The current wave of M&A shows no signs of abating. Sellers will no doubt seek to take advantage of frothy valuations before the market turns, and investors will eye the prospect of higher financing costs if inflation fears lead central banks to adopt more hawkish stances on interest rates. Thus, there are incentives for both buyers and sellers to make hay while the sun shines.