

McCANN FITZGERALD



WHAT'S NEXT FOR GLOBAL M&A?

McCann FitzGerald Global M&A Roundtable

Leading Irish firm McCann FitzGerald hosts a roundtable of some of the U.S.'s most prominent deal lawyers discussing global M&A trends.

Global M&A activity has been resurgent in 2014. As confidence returns to the boardroom, deal volumes are reaching levels not seen since before the financial crisis. Global M&A deal volume for 2014 was in excess of \$3.23 trillion by mid-November, according to Dealogic data, almost a third higher than the deal volume for the corresponding period in 2013, and the highest such deal volume since 2007.

With relative economic stability, share prices rising and borrowing costs low, conditions, at least in the U.S.,

are favorable for deal-making, but risks remain, and the sustainability of this long-predicted upturn in deal activity remains in question. The mood was optimistic but cautious at *The American Lawyer* roundtable in conjunction with leading Irish firm McCann FitzGerald.

We invited key deal advisors from Cleary Gottlieb Steen & Hamilton, Kirkland & Ellis, Skadden, Arps, Slate, Meagher & Flom, Shearman & Sterling and Simpson Thacher & Bartlett to share their views on the current state of the market and what the future holds in store for M&A in 2015.

FLASH IN THE PAN OR BOOM TIME?

Meeting in late November, just days after the biggest “Merger Monday” of 2014 saw the announcement of \$105 billion in deals, including the proposed \$66 billion acquisition of Allergan by Ireland’s Actavis and Halliburton’s agreement to acquire Baker Hughes for \$34.6 billion, the group was agreed that the global M&A market had strengthened considerably over the course of 2014.

McCann FitzGerald chief John Cronin¹, kicked off the conversation. “It seems to us looking over into the United States that there is a pretty benign political and economic position compared to maybe four or five years ago. It looks to us like a lot of big U.S. corporations have built up cash banks, they have weathered the storm and they are feeling good about things.”

“I think in general the factors are propitious for deal making,” agrees Simpson Thacher’s Mario Ponce.² “Currently you have high stock valuations, favorable financing markets and there’s a lot of confidence in the C-suite. I think in M&A there’s always this lemming effect when you have deal flow and momentum and other executives are sitting there and they don’t want to stand still, they want to feel like they’re being proactive and doing something.”

Skadden’s David Friedman³ agrees that there was an evident increase in confidence in the boardroom. “We’re seeing with respect to a lot of companies a focus on strategic



JOHN CRONIN

Chairman, McCann FitzGerald



CLARE O'BRIEN

Partner, Shearman & Sterling LLP

transactions, as well as a positive change in attitude in the C-suite,” he noted. “Several years ago, many companies were afraid to pay even what appeared to be an attractive price, because they didn’t have any confidence regarding what the right price for a target company should be, and there was fear that if prices market fell they’d look foolish. I think people now have more confidence with their decisions. They also realize that an easy way to address their strategic needs is through acquisitions.”

Cross-border M&A activity has significantly increased, with the U.S. the key target. According to Stephen Fraidin⁴ of Kirkland & Ellis, “some of the biggest deals have been cross-border transactions. I think the general stability and health of the United States economy and the political system here is attractive and I think it’s going to continue to be attractive for the foreseeable future. So, I think we’re going to see more foreign money coming into the United States.”

Ponce agrees: “A lot of companies during the recession cleaned up their balance sheets and they conserved cash. So, there are a lot of attractive U.S. targets that streamlined their operations and they’re ripe for the picking now.”

There are notes of caution. Clare O’Brien⁵ of Shearman & Sterling points out that, while the dollar value of transactions in 2014 has substantially increased over 2013, the number of transactions has not grown commensurately. “The growth in

¹ John is Chairman of McCann FitzGerald, a position he has held since May 2008. John has many years’ experience in banking, structured finance and capital markets matters

² Mr. Ponce is a Partner in the Simpson Thacher’s Corporate Department and a member of its Executive Committee. He recently represented Ingersoll-Rand in connection with the appointment of Nelson Pelz to the Ingersoll Board of Directors and the spin-off of Allegion plc.

³ Mr. Friedman has primary responsibility for designing and implementing shareholder rights plans for Skadden’s clients. On a negotiated basis, Mr. Friedman represented Chiquita Brands International in its proposed cross-border business combination transaction with Fyffes plc and its unsolicited, but subsequently agreed upon, \$1.3 billion merger with an affiliate of the Cutrale-Safra group

volume is either flat or barely greater than it was last year”, she said. “One of the things that we are seeing is larger transactions and fewer all-cash transactions. Approximately 26% of the transactions through September 30, were all-cash transactions and the others involve some stock component, so they are obviously being driven in part by the strong equity markets.”

Confidence may have returned to the C-suite, but it is a circumspect confidence. There was general agreement that the timetable for significant deals remains elongated, with boards anxious to safeguard corporate reputation by demanding extensive legal and financial diligence, antitrust analysis and assessment of execution risk.

HAS PE GONE AWOL?

In 2014’s flurry of activity, there is undoubtedly a preponderance of strategic deals and transformational M&A. “Companies have a lot of cash right now” says Benet O’Reilly⁶ of Cleary Gottlieb. “They’ve got a lot of confidence. Stock market valuations are significantly higher, remarkably high in some industries, such as biotech and pharmaceuticals. Our strategic clients are much more active than our private equity clients right now. I think private equity clients are having difficulties getting to the same valuations.”

So there is a possibility that the overall picture is being distorted by the fact that we are seeing the working though of strategic deals that have been in the pipeline for several years, pondered



DAVID FRIEDMAN

Partner, Skadden, Arps, Slate, Meagher & Flom LLP



STEPHEN FRAIDIN

Partner, Kirkland & Ellis LLP

over in the fallow period following the financial crisis. O’Brien agrees that private equity is finding it difficult to compete with the valuations reached by strategic buyers. “I think that one of the things that will be interesting to see is, now that private equity has accumulated a lot of money and financing is readily available, whether you’re going to see them competing more,” she says.

One indicator that the upturn in M&A activity would have become sustainable in the long term rather than a flash in the pan would be the return of the major private equity deals, argues Stephen Fraidin. “I don’t think we’re going to be able to say that we have a booming M&A economy until we see the really gigantic private equity deals that we saw for a while. We just haven’t seen the series of \$15 billion to \$25 billion dollar private equity deals that we did see. I think that the leverage is not going to be as high as it sometimes was but there is still going to be leverage.”

ACTIVISTS AS CATALYSTS

Activism, at least in the U.S., continues to be a major catalyst to the unlocking of deals. The role hedge fund Pershing Square Capital Management played in the agreed sale of Allergan has been much commented on, with Pershing Square’s collaboration with Valeant on a proposed purchase of Allergan putting Allergan in play ahead of the agreed deal with Actavis.

⁴ Mr. Fraidin has twice in the past three years received recognition from *The American Lawyer* as one of their “Dealmakers of the Year”. He is currently representing Burger King in its pending \$11.4 billion acquisition of Tim Hortons Inc.

⁵ Ms. O’Brien is a leading M&A lawyer and a recipient of a “Dealmaker of the Year” award by *The American Lawyer*. Her recent work includes advising Mubadala Development Company, a public joint stock company wholly owned by the Government of the Emirate of Abu Dhabi, in connection with its global business partnership with General Electric Company.

⁶ With a focus on public and private mergers and acquisitions and private equity investments, Mr. O’Reilly was an American Lawyer “Dealmaker of the Year” early in 2014. His recent experience includes representation of Brightstar and its founder in SoftBank’s \$1.26 billion acquisition of a 57% interest in Brightstar.

Fraidin notes, however, that activism can also have an inhibiting effect on deals. "I think activism has had a strange effect. It has driven some deals, such as the Allergan deal for example, but, in my mind it has also stopped companies from doing deals. Boards don't want to put themselves in a position where an activist says that you're doing a dumb deal, it's not accretive and we're going to stop you from doing it."

Shareholder activism, in the U.S. sense, is still less prevalent in European market, but that is changing. David Byers⁷ of McCann FitzGerald notes that U.S. hedge fund activists have turned to Europe, seeking opportunities outside the U.S. to utilize techniques successfully implemented at home.

That process has been accelerated by the inversion phenomenon. "There is now a significant cohort of substantial Irish and UK companies, created through inversion, which have a U.S. shareholder base, a U.S. listing and a U.S. history and outlook. We are seeing U.S. hedge funds familiar with these businesses becoming familiar with European legal mechanisms and dynamics in order to apply U.S. techniques. It's changing the European ground rules and the old assumptions," he says.

THE INVERSION WORD

In any discussion of cross-border M&A with a U.S./Irish aspect, it is inevitable that inversions are discussed, and with Byers' mention of "inversions," the discussion moved to tax and tax risk.



MARIO PONCE

Partner, Simpson Thacher & Bartlett LLP



BENET O'REILLY

Partner, Cleary Gottlieb Steen & Hamilton LLP

It is evident that a lot of the debate has been simplistic and sometimes misinformed. Michael Ryan⁸ of McCann FitzGerald notes that inversions raise few Irish tax issues. "For an inversion, the tax benefits arise mainly on the U.S. side and are typically an added bonus. You tend to find that the transaction itself is undertaken for commercial reasons."

Following the Treasury Department's move in September to inhibit inversion activity, the issue now is whether the projected strategic benefits of a deal will justify the tax costs that may arise. "It remains to be seen whether the withdrawal of previously available tax benefits will halt these transactions or whether the other commercial and strategic benefits that would arise from such transactions will justify shareholders bearing the tax cost that may arise," Ryan says.

O'Reilly agrees that most deals have a strategic logic outside of tax. "Mostly the deal-makers have other reasons to do the deals", he says. "The tax benefits may have been helpful, but not driving."

Some of the general corporate commentary on inversions has been superficial: "I think that some people didn't necessarily focus on the fact that inversions weren't a panacea in the sense that they are often taxable to the stockholders of the U.S. company and the full benefits may not be realizable when the U.S. company inverts, depending on the U.S. company's overseas subsidiary structure and the ability to leverage the US company with cross border intercompany debt" says O'Brien. Equally, she notes that "the effect of the Treasury Department's recent notice limiting the benefits to be derived from inversions is uncertain,"

⁷ Mr. Byers is one of Ireland's leading M&A practitioners. He recently advised Chiquita Brands International in its proposed cross-border business combination transaction with Fyffes plc.

⁸ Mr. Ryan is Head of Tax at McCann FitzGerald and for many years has advised US clients on transactions into Ireland.

although she also notes that since the date of the notice, more than one inversion transaction was terminated, the financing of another significant inversion transaction was modified to include debt financing instead of offshore cash, and there has been a noticeable decrease in the number of announced inversion transactions, as well as in the level of “chatter” about potential inversion transactions.

Ryan adds: “these recent changes announced in the U.S., and the planned changes and potential challenges by the E.U. Commission to European tax structures, have highlighted that tax risk is real.” He argues that there is an increased tax risk associated with historic matters and that this needs to be considered in assessing cross-border acquisitions. “In the past, very often the change of law risk was noted but not really given much weight given that the pace of change was expected to be so slow. But now we have seen changes take place in the U.S. and Europe on an accelerated basis, and we are not quite sure what the environment will be in, say, 24 months’ time.”

O’Reilly has the last word: “Some of us are optimists. I think that there may be a two year window where we could actually get some tax deals done. There is a lot that does not make sense about the U.S. tax rules no matter what side of the political spectrum you are on.”

THE REVERSE LEMMING

Undoubtedly, seeing a lot of big deals being executed gives other CEOs confidence to take transactions forward, but, tax risks aside, what could derail this momentum?

As a self-described “outside observer,” Byers comments that the extent to which U.S. deal makers are accepting risks to implementation of “bet the company” deals is remarkable. The outlook in Europe would be a lot more conservative. “No CEO embarking on a strategic deal wants there to be any significant risk of failure,” says Byers. “And this lemming effect that we were speaking of, it must work in reverse as well? I know for certain that some of the announced deals are being scrutinized very closely on merger control grounds, but there are other uncertainties as well, such as taxation, as we were saying. It may just take one significant deal to go with the wrong way and it will change people’s outlook.”

Both Ponce and O’Brien agree that it might take only a single high profile failed deal to change the tone. “I think that’s dead on. If there’s an antitrust suit involving one of the major deals...” says Ponce, “and there are some really big termination fees out there, \$2.5 billion or so...” adds O’Brien, “...so it won’t take much,” Ponce concludes.

The financing climate is also relatively fragile and might change quickly. Friedman notes: “One thing about financing is that markets can change very quickly. I think that people are starting to see a little bit more hesitation from the lenders. For a while, we were able to get commitment letters from banks with extended terms, and I think now the lenders are a little bit more cautious.”

Memories of the crisis are fresh. “Last month, I was working on a transaction that needed debt financing, and for two weeks or so, it seemed that access to the debt financing markets was



DAVID BYERS

Partner, McCann FitzGerald



MICHAEL RYAN

Head of Tax, McCann FitzGerald

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significantly affected by the volatility in the stock markets,” says O’Brien. “This resulted in somewhat of a flash back to 2008, and a sense of caution regarding the leverage levels that had become customary this year. I think that there is some sense that another shoe could drop, which we got a taste of in October. There is also a fair amount of geopolitical risk.”

O’Reilly notes that the changing nature of deal financing may bring new issues to the fore. “A lot of leverage for deal-funding these days is coming from the bond funds, and not from the banks—the banks are organizing the deals but the underlying money is coming from funds that are willing to participate in syndication. So, that’s a pretty new development and I don’t think anybody quite knows what will happen when things start to go sideways.”

CULTURAL DIFFERENCES

Any discussion between European and U.S. lawyers about cross-border M&A might be expected to touch on

differences in market practice. Cronin led a discussion of Irish/U.K. public takeover regimes, and the common observation that U.S. deal terms are significantly more “buyer-friendly” than those in Europe.

There was general agreement, however, that none of this deters companies from cross-border deal-making. Protectionism is different, and that potentially does deter potential purchasers.

“The U.S. is not perceived as particularly friendly to Asian and, particularly, Chinese buyers,” says O’Brien. “Continental Europe could be perceived as not particularly friendly to U.S. buyers, particularly when a transaction is unsolicited, and involves an iconic European company.”

Ponce agrees that such protectionism potentially inhibits U.S. cross-border deal-making, but sees differences in cross-border deal-making practice as surmountable. “It is just heightened awareness and counseling clients what the differences are and what some other issues can be. You can have some missteps, which is problematic. But I think at the end of the day, such differences are not going to stop cross-border transactions.”

Mistakes are made, however. Byers noted an instance where a U.S. potential acquirer lost its bid for an Irish public company through failure to appreciate the significance of its actions under the Irish takeover regime.

Differences in approach can lead to difficulty and close consultation among the lawyers is essential. Friedman notes: “The one thing that I have learned is that you cannot anticipate the differences in the way the respective systems and laws work,

and it is very easy to take a misstep, not intentionally, but because you just have a different mindset. But, I think cultural differences get worked out by being sensitive—How do I approach the other side? What should I not say? In our experience, cultural differences generally won’t inhibit a deal if the transaction makes sense.”

THE YEAR TO COME

Friedman sums up. “We’re all hoping for a good 2015, that’s for certain. In terms of what is actually going to happen, I think that we’re all a little bit uncertain. People feel 2014 was a good year, a better year than in 2013. But, obviously, there are questions now about the high stock prices, and whether cash deals are being priced out, especially when you factor in the required deal premiums. Add to that the financing markets, that are never certain, and the risk that there could be changes in lender sentiment. We are looking forward for there to be in 2015 a continuation of a focus on strategic transactions, but there’s definitely some uncertainty there.”

Fraidin suggests that the results of large transactions will have an impact: “We have had some big deals in the last couple of years and, if those deals turn out to be good deals, it is going to encourage people to make some more big deals. If they turn out to be bankruptcies or lose significant value, that is going to discourage people. Some of the failed big leveraged buyouts (LBOs) of the previous cycle undoubtedly have discouraged private equity firms from doing those sort of LBO deals. So I think we are going to know better when we see how some of these deals turn out.”

MCCANN FITZGERALD GLOBAL M&A ROUNDTABLE ATTENDEES:

- **DAVID FRIEDMAN**, *Partner*, Skadden, Arps, Slate, Meagher & Flom LLP
- **STEPHEN FRAIDIN**, *Partner*, Kirkland & Ellis LLP
- **BENET O’REILLY**, *Partner*, Cleary Gottlieb Steen & Hamilton LLP
- **CLARE O’BRIEN**, *Partner*, Shearman & Sterling LLP
- **MARIO PONCE**, *Partner*, Simpson Thacher & Bartlett LLP
- **JOHN CRONIN**, *Chairman*, McCann FitzGerald
- **MICHAEL RYAN**, *Head of Tax*, McCann FitzGerald
- **DAVID BYERS**, *Partner*, McCann FitzGerald