‘Tapping the brakes’ – H1 2018 Corporate outlook roundtable

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M&A Roundtable Recap

At a recent media roundtable in London, international partners from Hogan Lovells’ M&A, private equity and anti-trust practices offered their reflections on the most pertinent issues for global dealmakers in 2018; “With the fundamentals in place, we are looking into the new year with a much more positive outlook of where the M&A environment is headed”, said David Gibbons, global head of Hogan Lovells’ corporate practice.

Among the key themes, partners in attendance identified the following:

<u>*Brexit and protectionism*</u>

Brexit continues to loom large as negotiations approach their April 2019 deadline and the impact on UK business confidence is closely watched; “There has obviously been activity in terms of inbound investment into the UK because of the relative diminution in the value of sterling and the strength of the businesses here. The fact that the U.S. dollar has remained strong, coupled with the significant buying power of U.S. corporations, should continue to positively impact UK-inbound deal flow”, said Ben Higson, head of the London corporate practice.

Providing a US perspective, Gibbons added; “We’re seeing companies effectively hedging their strategy between the UK and eurozone, both from an investment perspective and in terms of exposure to ongoing Brexit negotiations, and fully expect this trend to continue into 2018.”

Higson added that debt markets have continued to be relatively benign in terms of the ability to borrow and the cost of repaying, helping maintain the UK M&A market at a level “people have been more pleased with than they were six months ago”, referencing the relative buoyancy of the oil and gas sector.

The eurozone has been characterized by its resilience in the face of political volatility, with Germany and France driving substantial activity. Volker Geyrhalter, a Munich-based partner and head of the corporate practice, Continental Europe, cited the Bayer / Monsanto transaction as the embodiment of this trend; ‘Strong economies produce strong deal flows – bold M&A transactions by German corporates into other European markets or the US was a feature of last year and something we should see more of.”

Tom Whelan, global head of private equity, touched upon the rise of protectionist sentiment and the impact that this could have on cross-border transactions; “A rise in the protectionist tide has the potential to stifle global cross-border M&A, particularly in light of ongoing discussions in the European Union around the screening of foreign investments.”

Continuing along the same theme, Suyong Kim, global co-head of antitrust and competition, commented: “We’ve seen resistance to advances from U.S. and Chinese buyers for strategic or heritage businesses in Europe but it remains to be seen, once it exits the union, how the UK will deal with inbound investment and indeed how UK outbound investment will be perceived by the EU and its members. As to pure merger control, after Brexit, mergers of a certain scale will still continue to be vetted under the EU rules but often with an additional UK review.”

‘The return of the China premium’

In early November 2017, the Chinese government further tightened controls over outbound investment by requiring regulatory approval for foreign acquisitions conducted through an offshore entity. The guidelines come at a time when China’s currency reserves have risen for eleven straight months, now exceeding 3.13 trillion RMB.

Andrew McGinty, co-head of Hogan Lovells’ Asia corporate practice, views the move as consistent with broad efforts ‘to consolidate state power’, particularly in the area of outbound transactions. McGinty broke down China’s new classifications for outbound projects into three categories based on State Council guidelines issued in August 2017: encouraged, restricted and prohibited. Investments in infrastructure linked with the Belt and Road Initiative are at the top of the "encouraged" list, while transactions in real estate, hotels, entertainment and sports now find themselves in the "restricted" category.

McGinty added; “The China premium is coming back. I have spent ten years trying to get rid of the China premium, arguing with counterparties that you don’t need a China premium because the regulatory framework for outbound has been simplified over the years - then suddenly with the capital controls – it’s all come back again. Deal uncertainty is having a direct impact on pricing. There is now a lot of emphasis on finding Chinese buyers who are able to deploy pools of capital outside of mainland China, typically in Hong Kong.”

Speaking on the same theme, Whelan, added: “We’re also seeing a lot of pressure on Chinese companies who have deployed money overseas to actually repatriate capital into China – they are being forced to either list or sell companies and return cash. This, in turn, could act as a driver for M&A as new assets come to market.”

‘Private equity loves tech’

Despite global M&A statistics suggesting a depressed year for aggregate deal value, 2017 saw a series of high-profile tech acquisitions by private equity firms.

“Private equity loves tech, and many prognosticators, myself included, think the U.S. tech sector is in for a large rebound in 2018,” said Silicon Valley-based M&A partner Rick Climan.

Both Whelan and Climan said that, combined with high levels of dry powder and cheap debt, some private equity firms have now established large enough portfolios in the tech space to be able to leverage synergy-based advantages that were once unique to strategic buyers. These PE firms are now able to outbid those strategic buyers in some sales processes.

Another trend that could emerge among private equity buyers is an increase in the number of consortium deals. Climan believes that this trend will be stronger in Europe than in the U.S., where PE firms are still mindful of the large settlement payments made to settle a high profile lawsuit commenced in 2007 alleging that the firms colluded with one another to hold down the prices paid in their acquisitions.

Alongside private equity, Climan suggested that an ‘expanding class of buyers’ is becoming part of the tech landscape in the U.S., including strategic buyers located outside the U.S. and non-tech strategic buyers looking to digitize their business models, something we’ve seen with particular prominence in the automotive and retail sectors.

Climan also observed that, in the tech sector, many traditional industry verticals are breaking down; “It used to be that software companies only bought other software companies, hardware companies only bought other hardware companies and e-commerce companies only bought other e-commerce companies,” he said. In today’s market, that’s not always the case. “The lines separating these subsectors have become blurry.”

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