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CROSS-BORDER MERGERS

Global M&A Trumps Populism and Politics

BY BILL CURTIN AND ERIN HOWELL

A year has passed since the British voted to leave the EU. That big surprise was rapidly followed by another one – the election of Donald Trump as President of the United States. These elections showed us that many voters, in both the U.S. and the UK, believe that globalization – and the free trade and immigration that comes with it – have had a negative influence on their lives.

And the swell of populism has persisted. While Marine Le Pen was not victorious in France, she championed the views of a vocal nationalist movement there. Polls relating to the elections coming up in Germany suggest that the allure of protectionist sentiments cannot be entirely ignored in the Federal Republic, either.

Despite these populist movements, global M&A activity remains strong. According to Thomson Reuters, global M&A reached $1.6 trillion during the first half of 2017, amounting to a 2% increase over the same period last year. At $630.9 billion, cross-border activity accounted for 40% of the overall M&A volume and reached its highest level for the first half of a year since 2007.

Bill Curtin is Partner and Global Head of the Mergers & Acquisitions group at the international law firm Hogan Lovells. Erin Howell is a senior associate in the Mergers & Acquisitions group at Hogan Lovells.

These strong M&A numbers demonstrate that dealmakers are still seeking to globalize. Rather than risk being left behind, global dealmakers are successfully navigating political and populist headwinds to get their deals done.

Navigating Headwinds

To extol the virtues of globalization does not seek to minimize the impact of the invocation of Article 50 in the UK or plans to expand the border wall between the U.S. and Mexico. These are momentous decisions, with far-reaching effects that cannot be ignored. Even more, these types of nationalist inclinations have emboldened regulators and competitive review mechanisms. As a result, increased complexity has been injected into dealmaking across geographies and by regulators.

Notably, China has not occupied center stage this year for global transactions. In 2016, Chinese buyers engaged in record levels of transactional activity. However, 2017 has been witness to a dramatically different story, as new Chinese regulations aimed at stemming the flow of funds outside of Asia, combined with the heightened scrutiny of Chinese buyers under CFIUS, have resulted in a 49% decline in China-outbound M&A compared to the same period last year (as reported by Thomson Reuters).

Business conditions and legislative inertia are relevant drivers, too. To the chagrin of business leaders who believe in non-organic growth through M&A, high

valuations and soaring capital market indices make U.S. companies expensive targets, and tax and deregulation reforms and infrastructure investment promised by the Trump administration have yet to materialize. Compounding the lack of legislative progress, the Trump administration announced a delay in implementation of the ''start-up visa'' program intended to facilitate innovation and U.S. tech-sector job creation by allowing foreign nationals to come to the United States to start new companies, and has pledged to investigate pricing of pharmaceutical products, a popular move politically, but one that could have a negative impact on acquisitions of drugs currently marketed or close to commercialization in the U.S.

Taken together, some commentators believe that increased headwinds will impede M&A as a source of growth initiatives. But, as we reach the halfway marker to 2017, that has not occurred; and, although the rise of populism and growth of nationalism present considerable headwinds, the real story is that the strength of globalization, and the medium of global deal-making, remain as strong as ever.

Despite Headwinds, Globalization Persists

CEOs and business leaders today face the imperative of technological progress. Across nearly every sector, and regardless of the headquarter location of today's multinational companies, an inability to innovate is tantamount to investing in the Flintstones rather than in the Jetsons. In view of the costs, timespans and business risks inherent in relying exclusively upon internal resources to accomplish innovation, the world's leading companies are increasingly looking to ''technology and talent'' transactions through which to accelerate the non-organic development of innovative technologies.

Cross-border M&A deals are shifting away from the pursuit of synergies and economies of scale - key deal-drivers in the past - to focus on technology innovation, integration and enhancement. This shift in focus runs across all sectors, as industries from automotive to financial institutions to pharmaceuticals are increasingly defined by technology. In a recent survey conducted by Deloitte of executives with experience in cross-border deals, almost 50% of those surveyed identified either acquiring intellectual property or securing new product technologies as their top strategic deal objectives.

As companies seek out innovative technologies, the automotive industry illustrates how globalization is shaping corporate decision making today. Tesla Motors, the electric car company, saw its valuation surpass that of General Motors, suggesting that Tesla's investors are optimistic about the company's growth prospects. Although Tesla has invested hundreds of millions of dollars to establish itself in the automotive industry, it has yet to become a profitable money-maker (Bloomberg reported that Tesla has had only two profitable quarters since its founding in 2003). Nevertheless, investors consider Tesla more valuable than General Motors, itself one of the world's most established car makers with its wide distribution, substantial scale, global goodwill and brand recognition.

Globalization is at the heart of this apparent anomaly. Tesla's raison d'être is innovation, technology and connectivity. Elon Musk, Tesla's CEO and co-founder, isn't driven by a desire for Tesla to become the world's largest carmaker. Musk has a more significant goal; he wants to change the very foundation of how (and where) we travel.

Take the decision by rivals Audi, BMW and Daimler to join together as an unlikely consortium to buy the digital mapping business, HERE, for $3.1 billion. This was a cross-border deal driven by the key trend of connectivity, a long-term bet on the continuation of the forces of globalization. The deal also showcased that CEOs are willing to explore new ways to access innovation – a revision of the traditional M&A handbook – if the ultimate prize is deemed sufficiently worthy.

Because the technological and economic innovations driving globalization are now deeply rooted, countervailing political headwinds are simply not strong enough to stop the continued advance of globalization.

Deal drivers will continue to evolve with the times, but the billions of people who have benefitted from globalization are not about to regress into the false positives of nationalism. Lives have been changed for the better through improved communications, technological integration, mobility, healthcare and education. These are incredibly powerful factors.

Getting the Global Deal Done

Executives wishing to exploit the advantages of global deal-making while mitigating the risks of an increasingly complex political and regulatory landscape recognize that due diligence in cross-border deals is more important than ever. In today's climate, compliance, tax, foreign investment, and antitrust assessments frequently have a significant impact upon the value associated with a transaction, and sometimes even have the ability to derail a transaction.

Expectations as to appropriate standards of compliance can vary dramatically among companies and across jurisdictions. These varied expectations require heightened scrutiny of compliance practices, particularly given that acquirers have been held liable under the Foreign Corrupt Practices Act as successors-in-interest for pre-acquisition violations by or on behalf of an acquired party, and for failing to take adequate steps post-acquisition to prevent or mitigate violations by the acquired party.

Promises of tax reform in the U.S. signal the likelihood of lower corporate tax rates, repatriation of offshore cash at a reduced tax cost, and fundamental changes to the taxation of U.S. companies with international operations. Understanding the potential effects of tax reform is therefore increasingly critical to designing structures for cross-border transactions, implementing cash repatriations and modifying existing corporate structures.

The prospect of increased CFIUS examination of certain foreign investments into the United States underscores the need for parties to evaluate at an early stage whether their transaction might implicate national security concerns within the U.S. Even transactions involving industries not traditionally considered as raising significant national security concerns, such as the hospitality, financial, automotive, and insurance sectors, may now fall susceptible to review by CFIUS – and to foreign investment filing requirements in countries other than the U.S., particularly those countries with

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which the U.S. Government routinely shares intelligence.

And, in the high visibility arena of competition review, parties transacting in the global marketplace must now take into account as part of routine diligence the pre-merger notification requirements of more than 100 antitrust authorities around the world, and must recognize that recent transactions have faced active, and frequently coordinated, reviews in the U.S., the EU, Canada, and other jurisdictions. The increasing emphasis on global antitrust enforcement suggests the need for buyers and sellers not only to assess a transaction's impact on the competitive landscape, but also to align contractually with respect to the scope of acceptable remedies and to plan for the contingency of extended investigations.

Countervailing forces to globalization, in any of the forms outlined in this article, might reasonably prompt pause for thought. But not more than a pause, which itself should provide M&A participants a window within which to carry out the necessary diligence steps and to secure the important contractual protections noted above. Markets remain supportive of meaningful valuations and companies have done well solidifying their balance sheets in recent years. This means that the strategic drivers and conditions for M&A remain positive. Amidst the short-term fog of populism, nationalism and geopolitical volatility, just as globalization has defined deal-making over the last 20 years, it will continue to do so for the next decade.