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Transatlantic M&A set to continue growth amid Brexit and Trump administration uncertainty

UK corporates responding to uncertainty surrounding Brexit by expanding global presence.

U.S. corporates facing pressure to deploy significant cash piles.

In recent times, the M&A landscape has been dominated by the “Special Relationship” between the United States and the United Kingdom. As two of the most consistently stable members of the global economy, they have made the transatlantic corridor the busiest in the world for transactions.

However, the past two years have seen reduced deal flow between the UK and U.S. and have cast doubt over the future, with both nations hit by political and macro-economic uncertainty as a result of Brexit looming in the UK and the impact of Trump administration policies and tax reform in the U.S..

When the British pound slumped overnight against the U.S. dollar following the UK’s vote to leave the European Union in June 2016, it was feared that UK companies would become sitting ducks for foreign investors looking to snap up high quality companies at low prices.

It initially looked like things were heading that way when, less than a month after the Brexit vote, AMC Entertainment announced that it was to acquire the London-based Odeon & UCI Cinemas Group from private equity firm Terra Firma for $1.2 billion.

Then, in February 2017, Kraft Heinz’s $143 billion swoop for Unilever sparked calls from UK corporates for the UK Government to introduce measures to enable it to intervene to protect “national champions”.

However, Kraft Heinz’s bid was short-lived, and in fact UK inbound M&A dropped significantly in 2017.

Despite an immediate post-Referendum wobble, the FTSE 100 index has seen impressive growth, hitting an all-time high in January of this year. This jump was a result of an inverse correlation between performance of the FTSE 100

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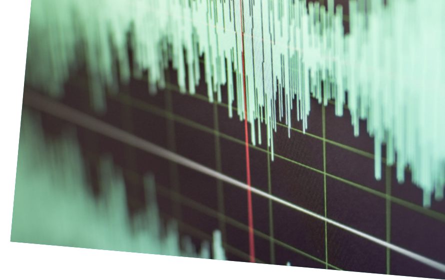

and sterling exchange rates. Because around 75% of FTSE 100 companies' revenue is generated overseas, converting that revenue back to sterling was a boost to U.K. corporate balance sheets.

This boost has given many of the UK's largest companies the ability to take strategic steps to hedge against post-Brexit uncertainty.

Rather than waiting for the UK Government to implement protectionist measures, UK companies are adopting attack as the best form of defense, and using M&A to sustain growth: in 2017 UK outbound M&A soared to a 17-year high at nearly $110 billion.

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The largest portion of this comes from two transatlantic mega-deals: British American Tobacco's $47 billion acquisition of Reynolds and Reckitt Benckiser's $17 billion acquisition of Mead Johnson. Both of these deals have given large listed UK corporates with multijurisdictional operations a more durable presence in the U.S. and also reduced their exposure to post-Brexit instability.

On the other side of the Atlantic, U.S. outbound investment in the UK initially slowed after June 2016, with many U.S. corporates instead choosing to deploy capital in Continental Europe or further afield. In the second half of 2016 and continuing through 2017, U.S. corporate investment in Continental Europe soared to $365 billion, a 55% increase over the prior 18 month period.

However, there is increasing evidence that investor trauma around Brexit is beginning to subside. With the UK set to leave the EU on 29 March 2019, and an agreement now reached on a subsequent 21-month transitional period through 2020, a functioning future relationship between the UK and the EU seems more likely than at this time a year ago.

However, U.S. investors are now faced with further uncertainty as a result of U.S. tax reform driven by the Trump administration and the Republican-controlled Congress.

The Tax Cuts and Jobs Act, passed by Congress in late 2017, is proving to be the most significant revamp of the U.S. tax system for a generation.

From a transaction perspective, the lead up to tax reform and its surrounding uncertainty had forced a number of major U.S. investors onto the back foot when structuring their deals, especially when it comes to issues such as tax efficiency.

While it looks like this will only be a temporary hold up and U.S. deal volumes have once again soared in the first quarter after adoption of tax reform, other Trump administration policies could significantly disrupt or delay existing deal processes and discourage wary foreign investors from entering the U.S. market.

That said, there are components of the tax legislation that may give global M&A a significant boost – the cash flow effects of reduced corporate tax rates and repatriated income will increase the amount of available capital that U.S. corporates are able to deploy.

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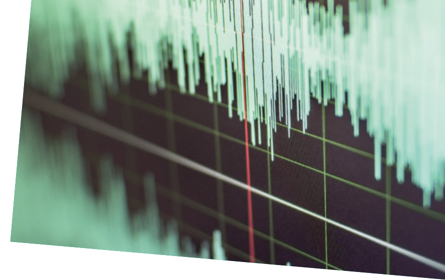

Under the Act, tax rates for U.S. corporations were reduced substantially and U.S. companies will be able to repatriate cash earned and held abroad at a discounted rate. Some have estimated that this will lead to as much as $2 trillion flowing back onto the balance sheets of companies who are already benefitting from strong stock market performance and cash piles in addition to benefitting from reduced corporate tax rates.

When you factor in the increasing amount of dry powder being collected by private equity funds, now estimated at around the $1 trillion mark, investors are facing ever greater pressure to put their money to work.

The question becomes, what to do with all of this free cash. Share buybacks and dividends were popular in the past, but in a world of inexpensive financing and moderate organic growth, acquisitions seem to be the natural way forward.

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Because of the competition for good assets, the challenge is to find good quality companies at the right price. With private equity firms, strategic buyers and major corporates all in the mix, global valuations are increasing and returns are falling.

But despite this challenge, the UK remains a hotbed of high-quality, promising companies across a number of sectors. To the cash-rich U.S. investor taking a long-term view, the need to source returns may well overcome concerns around Brexit.

So while macro-economic uncertainty looks set to continue, transatlantic deal-making is well placed to see sustained long-term growth. It seems the Special Relationship is very much alive.

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