M&A IN A CHANGING EUROPEAN LANDSCAPE:

CAN THE BOOM SURVIVE BREXIT?

Political uncertainty is generally bad for business. But when it comes to merger and acquisition (M&A) activity, this may not necessarily ring true. The UK's impending and uncertain split from the European Union and ongoing international trade tensions are doing little to dampen enthusiasm for M&A.

The M&A market continues to exceed expectations. After having crossed the $3 trillion annual mark for four consecutive years, the M&A market crossed the $1 trillion mark within the first three months of 2018 – the fastest pace ever.[1] International tensions concerning Russia, global protectionist trade policies and the future Brexit have not significantly dented buyer and seller confidence, at least for now. Brexit and other international conflicts may be an iceberg looming ahead of the ship, but there are other forces at play under the surface, such as:

- The current environment of **very low interest rates** is raising pressure on investors looking for a return on their money. Private equity has about $2 trillion in capital it needs to spend to achieve positive investment returns. As a result, it is a seller's market that is increasing valuations.
- Rather than waiting for any number of international tensions to resolve, **buyers are needing to act**. Buyers in all industries are fighting to stay relevant and remain resilient in very uncertain times.
- **Growth in secondary transactions**, where private equity firms reshape their portfolios and sell off certain assets to other private equity firms, is driving the M&A market. There were 576 such transactions in 2017, but only 394 in 2007.

Brexit

After the Brexit vote, many dealmakers paused to consider whether to proceed with live M&A processes. Most are now assuming a no-deal basis and working on M&A accordingly. If there is a certain and binding Brexit agreement with the EU, all the better.

Despite the uncertainty, UK-to-UK transactions are increasing, as companies try to shore up capital and address strategic gaps – seeking to become as strong as possible in advance of Brexit. As case in point, there was a 70% increase in 2017 in domestic UK M&A volume according to Dealogic.

M&A Post-Brexit

A pattern of M&A activity that shifts focus on European companies building up their balance sheets by engaging in intra-EU M&A is likely, leaving the UK as an outlier. While Brexit could be seen as liberating and more outward-looking, it appears the reverse may be happening. There is an increasing trend for UK companies looking at transatlantic deals as well as an increase in domestic deals.

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Protectionism and Government Action

Alongside this, companies and their advisers are addressing the impact of politics on deals.

"We are in a global economy, but increasingly, governments are focusing on more control within their borders," says Roger Barron, partner in the London office of Paul Hastings. "This may reduce the number of potential buyers, and sellers need to be mindful of the potential impact on execution risk."

The UK government plans to strengthen the Enterprise Act to reflect national security concerns rather than just national interest – a big departure for an inbound-friendly country. Barron explains that this will add complexity to clearances and tighten conditions for merger approvals. In any given year, there are about 200 deals that can be caught up in this, much more than in the past.

Governments are looking down the modern business supply chain to consider how important they are to critical national infrastructure. As Barron explains, a great deal of M&A buyers from Asia looking at Europe purchases will be scrutinized when it comes to the loosely defined critical infrastructure industries.

In terms of country risk, China is an example, but it is not alone. Recent failures have made such buyers more wary to ensure a successful deal. This, in turn, impacts the way deals are viewed from the seller's perspective. If, for example, the main bidder is a potential risk, there is often more emphasis on keeping the second bidder at the table in case the first bidder falls through.

These restrictions could be offset by a more expansive view of antitrust issues. Many mergers in the past did not go forward because of concern they would limit competition. Now, competition is being felt from massive businesses that span the globe, so deals are more apt to be approved than in the past. The view of antitrust issues has changed recently in countries like France, where President Macron has taken a more pro-pan-European approach to M&A supportive of larger, more pan-European deals.

It Is All About Money

The pressure to get deals done is driving M&A. "Are we in a dangerous phase when the market, awash with cash, moves away from a more balanced approach to deal making?" asks Barron. "Considering how cheap debt is and how willing big investors are to look at other parts of the capital structure, mergers are certainly in motion."

Barron contends that due diligence as a long, slow process is ending, as more efficient and effective processes are developed. This includes artificial intelligence solutions, streamlining the document production process and digitization. Finding ways to avoid months and months of conducting due diligence will be critical – otherwise, the risk of losing the opportunity is real. Speed to market is crucial for a successful M&A player. If a potential buyer cannot act fast enough, it could be swamped by other bidders.

In terms of debt, leverage and cash, many different structures have arisen in the market. While private equity has traditionally been more leveraged, infrastructure funds have grown in importance and are less leveraged. For corporations, it is an excellent time to secure funding as the risk assessment in banks has become more sophisticated and rigorous.

The Core Driver – Technology

Technical convergence, within and outside the technology sector, is key. Looking ahead, M&A will be increasingly driven by building technical capacity. It is essential to understand that the mission-critical data of tomorrow's business environment lies in every company's data systems – not just those companies in the high tech sector.

Additional areas that will increasingly drive M&A activity include:

- Renewable energies, especially as they move away from a subsidiary-heavy regime
- Utilities and related industries, such as energy brokers driven by distributed energy, all of which involve technology solutions

A lasting Brexit agreement may or may not be made. Trade tensions may ease or sharpen. Fuelled by a need to stay ahead of the competition, M&A bidders are leveraging technology and cheap debt to stimulate activity now and in the future.

For more information, please contact Roger Barron, Partner, Corporate Department at Paul Hastings LLP or visit paulhastings.com.

[1] The beginning of a new M&A season: Future of the deal, Deloitte,https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/mergers-acqisitions/deloitte-uk-future-of-the-deal.pdf