US M&A 2014–15: Full steam ahead

A review of the drivers behind 2014's banner M&A year and a look ahead to 2015

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US M&A hits a home run

On the back of headline-grabbing megadeals and a more stable economy, US M&A staged a dramatic comeback in 2014

The final figures are in, and it is safe to say that 2014 was a home run for the US M&A market. Deal activity was at its highest level in five years.

A number of factors have increased confidence among corporates, bringing them back to the dealmaking table with a fervor. Stock markets are strong in the United States, and many companies have substantial cash piles to invest as well as the backing of shareholders pressing for more deals. Importantly, the US economy is stable and growing—particularly compared to markets in Europe and Asia—and this is attracting an increasing number of non-US buyers to the United States.

Megadeals, such as the proposed US$66 billion acquisition of Allergan by Actavis, have been at the forefront of the revival and helped to drive the value increase, as sectors, such as pharma and TMT, looked to consolidate.

The number of deals also increased significantly, although not as much as value. We expect a broader, deeper and more active M&A market in 2015, with the prospect of dealmaking activity spreading to the under-US$5 billion market, which will drive volumes higher.

In the private equity arena, buyers have stepped back somewhat due to extremely high seller expectations. The value of acquisitions by buyout firms was only 11 percent of total deal value, the lowest in three years and a significant drop from 33 percent in 2007. However, increased volatility in the market, which we have seen in the first weeks of 2015, may create greater opportunities if prices decline. On the other hand, there is no certainty that sellers' expectations will quickly reset.

Overall, deal value fell in January compared to December, but that is consistent with patterns in recent years, with value remaining static or falling from December to January in the previous two years.

The momentum built in the last year looks set to continue into 2015, but there is no room for complacency. Dealmakers will be very aware of recent stock market volatility, falling oil prices and a potential pullback in the leverage markets.

Although buyers should proceed with caution, there is good reason to be optimistic about the M&A markets in 2015.

John Reiss
Partner, White & Case

Gregory Pryor
Partner, White & Case

The US M&A market takes center stage

HEADLINES

■ US deal values reached a five-year high in 2014 ■ Deal volumes were up by almost a quarter compared with 2013 ■ Stable economy, record cash balances and backing from shareholders have set the foundations for a rise in M&A ■ Megadeals are up 51 percent in volume and 67 percent in value ■ Deals under US$1 billion are up 18 percent in volume and 28 percent in value

After a long hiatus, US M&A activity sparked back to life in 2014 to record its best performance in five years. Companies announced 4,795 deals worth US$1.4 trillion last year, a 22 percent increase in volume and a 57 percent rise in value on 2013 figures. US dealmaking has finally recovered since the beginning of the downturn in 2009, when there were just 2,771 deals worth US$688 billion.

"M&A lawyers have lived through a difficult period since 2008, but in 2014, the M&A market has come roaring back," says John Reiss, the Global Head of White & Case's M&A practice.

The revival has been underpinned by positive fundamentals. The US economy is expected to show growth of around 3 percent for 2014, the S&P 500 gained 11.24 percent through the year and, in December 2014, unemployment fell to 5.6 percent from 5.8 percent. This compares extremely favorably with both Europe and Asia. For example, the European Commission recently cut the Eurozone growth forecast from 1.2 percent to 0.8 percent, and the unemployment rate stands at 11.5 percent (where it has been since June). Meanwhile, 2014 witnessed China's slowest growth in nearly a quarter of a century.

Deal drivers

The M&A renaissance in the United States has taken place against a backdrop of soaring values and record performance in the global M&A market as a whole, with deals totaling US$3.2 trillion. At 16,554 deals, global transaction volume in 2014 was 14 percent higher than in 2013.

51%

The percentage increase in megadeals from 2013 to 2014

In the United States, the stable economy, shareholder enthusiasm for deals and record corporate cash (standing at around US$1.6 trillion, according to Moody's Investor Service) have laid the foundations for recovery.

The return of the megadeal in the United States has served as a key pillar of the M&A rebound and suggests that US dealmakers have the conviction to pursue deals and make large, long-term strategic plays once again.

Megadeal mania

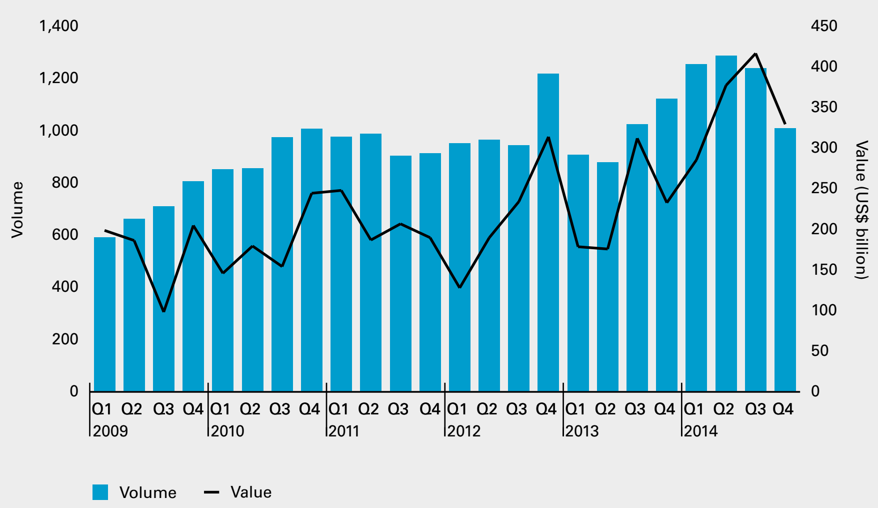
There were 243 megadeals in 2014 worth a total value of more than US$1 trillion, which marks an increase of 51 percent and 67 percent compared to the 161 deals worth US$652 billion in 2013 (megadeals are deals worth over US$1 billion). The spike in these high-value transactions helped to boost overall deal value for the year.

"Something has changed for buyers and sellers," Reiss says. "The buyers are through their restructurings. They have done what they can on the cost side. Now they have lean, growing business operations, and they are ready to transform through acquisitions. The thing that has changed for sellers is that buyers are now willing to meet their price expectations—and when you have enthusiastic buyers (even at high prices), you get willing sellers and a highly charged M&A market."

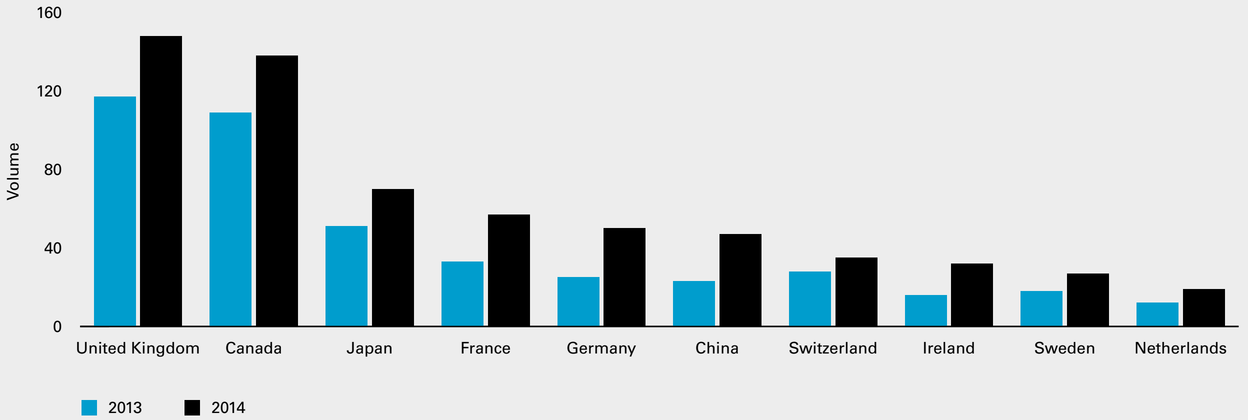
Stock is an option

Another indicator of the confidence that has flowed through the US M&A

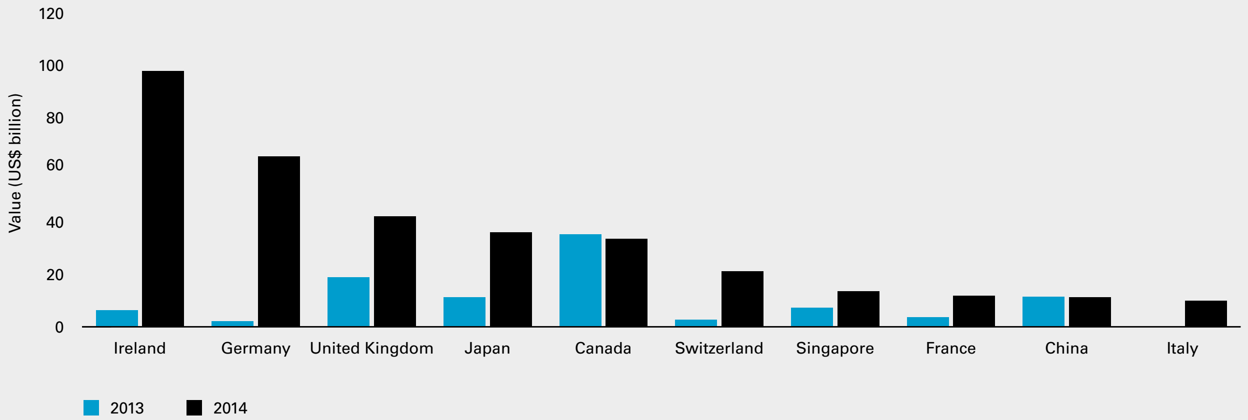
Total US M&A, 2009 – 2014



US inbound M&A – top bidders by volume



US inbound M&A – top bidders by value (US$ billion)



> **"The thing that has changed for sellers is that buyers are now willing to meet their price expectations—and when you have enthusiastic buyers (even at high prices), you get willing sellers and a highly charged M&A market.**
>
> John Reiss, Global Head of M&A, White & Case

market in 2014 was the willingness of sellers to accept stock consideration.

The use of equity to fund deals has been on the rise with the number of deals in which sellers accepted equity as part of the consideration rising to 18 percent in 2014, the highest percentage recorded in the last six years.

"A substantial amount of deal consideration is paid not in the form of cash but in the form of equity, evidencing confidence in the equity of the acquirer," says White & Case partner Gregory Pryor.

Inbound on the up

The growth supporting the rise in US deal activity did not go unnoticed abroad, and interest from international dealmakers in the United States was strong.

The number of deals in the United States by the 10 foreign countries most active in M&A climbed from 432 in 2013 to 623 in 2014, with deal values more than trebling from US$99.1 billion to US$342.8 billion.

Recovering global M&A markets and steady US growth spurred inbound investment into the United States such as German group Bayer's US$14.2 billion takeover of Merck & Co.'s consumer care branch and Chinese multinational Lenovo's US$2.1 billion acquisition of IBM's x86 server business.

Three sectors driving deal value

HEADLINES

- TMT was the most active sector with 1,029 deals in 2014
- M&A was driven by consolidation and bundling in the TMT market
- Energy, mining and utilities recorded the highest value in 2014 with US$318 billion worth of deals, more than double that of 2013
- In the pharma, medical and biotech sector, deal value rose 134 percent between 2013 and 2014, from US$100 billion to US$232 billion

Three sectors—technology, media and telecommunications (TMT), energy, mining and utilities (EMU) and pharma, medical and biotech (PMB)—accounted for the lion's share of US deal value in 2014, with activity driven by consolidation, strong foreign appetite for assets and tax inversions.

There were 1,029 deals in the TMT sector in 2014, with a total deal value of US$302 billion, up six percent from 2013. Megadeals dominated the sector.

The increase in the use of wireless devices caused a blurring of the lines between television, mobile telephony and broadband. In response, cable providers and mobile operator companies have moved to consolidate and bundle these services together.

Megadeals were also the driver in the EMU sector, which recorded 495 deals in 2014 and in which deal value more than doubled from US$139.6 billion in 2013 to US$318.1 billion. Strong appetite for midstream assets was a major contributor to the sharp rise in value, as was keen interest from foreign investors in shale gas plays. A fall in the price of oil in the final quarter also brought out buyers seeking to acquire assets at lower valuations.

134%

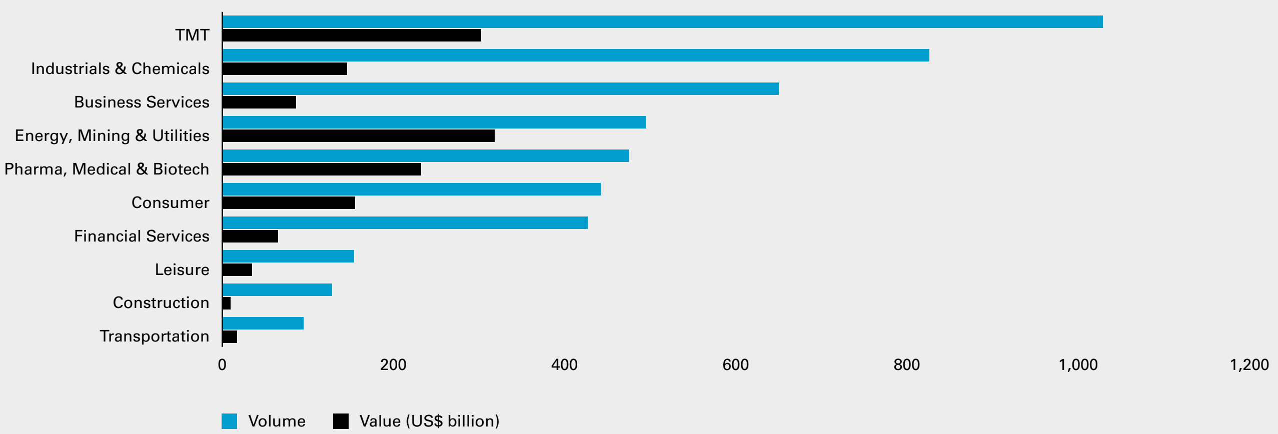
The percentage increase in deal value in the PMB sector from 2013 to 2014

The 475 deals in the PMB industry last year ranked the sector as the third-largest contributor to overall deal values in the United States. PMB deal values more than doubled from US$99.5 billion in 2013 to US$232 billion.

Activity was partly prompted by the need for PMB firms to replenish drug pipelines and find synergies to reduce R&D costs, but the main driver of activity in the sector was tax inversion deals, where US businesses acquire foreign companies and transfer their tax domicile to secure lower tax rates. Medtronic's US$45.95 billion purchase of Ireland's Covidien and Actavis's takeover of Warner-Chilcott for US$8.4 billion were two of the high-profile tax inversion deals in PMB last year.

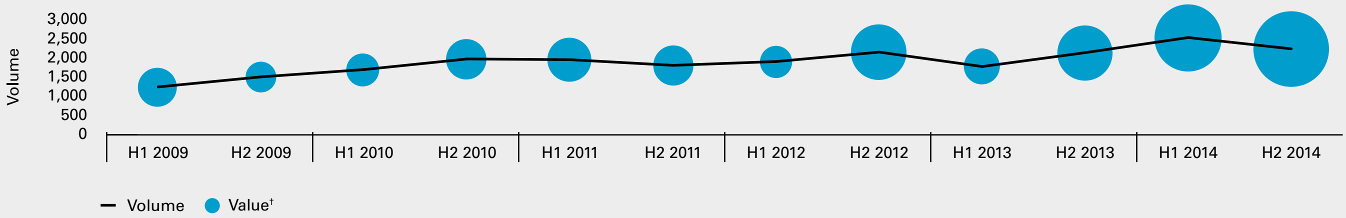
The US Treasury did respond by introducing regulations restricting some of the advantages associated with tax inversions. The new rules have blocked companies from using cash trapped offshore to fund overseas deals without incurring tax, although it is still possible to leverage US operations and deduct the interest against US taxable income post-acquisition. "While the government has moved to restrict inversions, we believe that these will continue to get done in certain circumstances," says White & Case partner William Dantzler.

Total US M&A – top ten sectors 2014



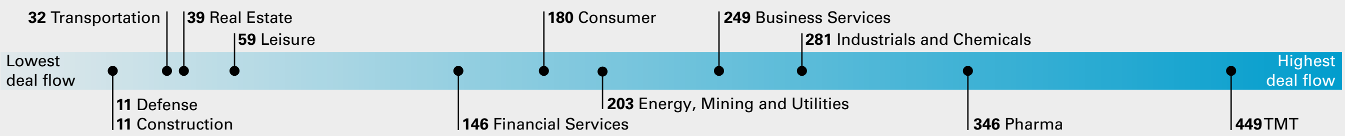
US M&A in figures

Total US M&A 2009 – 2014

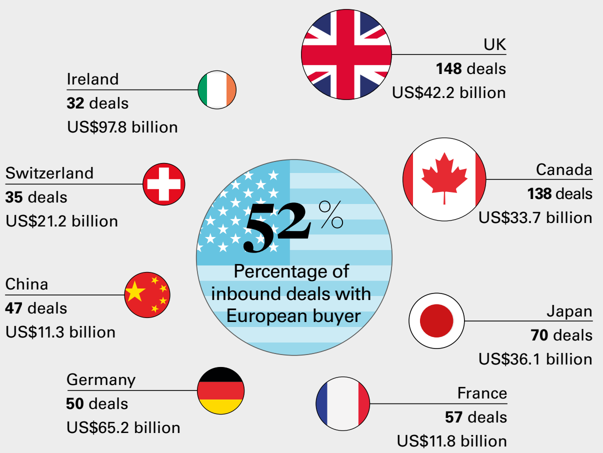


TMT, pharma and industrials poised to be most active in 2015

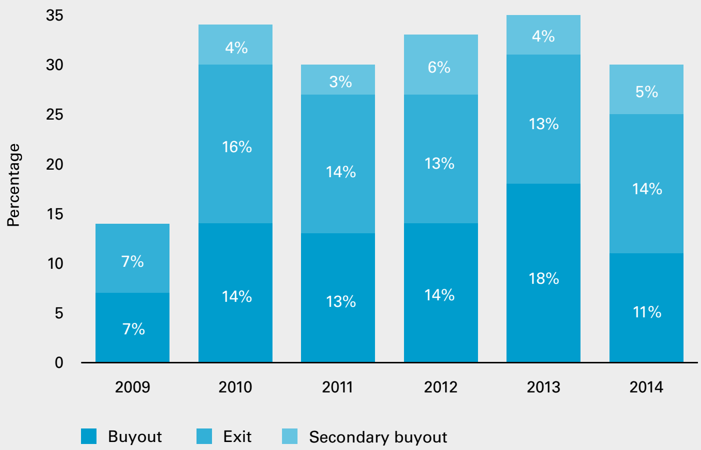
The M&A Forecaster* predicts sector deal flow by volume in the US M&A market for 2015.



Inbound M&A by country, 2014



Proportion of US M&A accounted for by private equity



† Indicated by size, where the smallest is US$303 billion, and the largest is US$747 billion

* The Intelligence Forecaster is based on "companies for sale" tracked by Mergermarket in the US between 1 August 2014 and 31 January 2015. Mergermarket's Intelligence Forecaster of predicted deal flow is based on intelligence relating to companies rumored to be for sale, or officially up for sale. It is therefore indicative of sectors that are likely to be most active during 2015.

PE exits reach five-year high

HEADLINES

- Private equity exit values reached a five-year high
- Exit volumes increased 31 percent from 2013 to 2014
- Buyout volume was up 14 percent from 2013

Private equity firms took full advantage of the US M&A rebound in 2014, seizing the opportunity to exit more portfolio companies than at any time since the bottom of the market in 2009.

Private equity investors sold 962 companies worth US$261.8 billion last year, an increase of 31 percent in volume and 70 percent in value compared to the 735 exits worth US$153.6 billion secured in 2013. Indeed, exit values were five times higher in 2014 than they were in 2009.

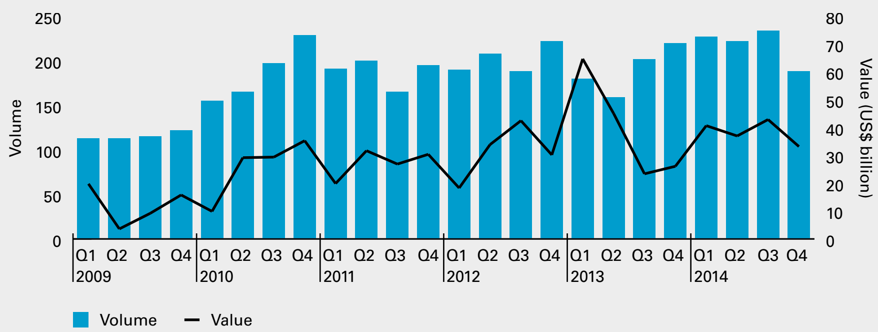
A number of factors have spurred this run of private equity exits. Stronger portfolio company performance; the return of well-funded strategic buyers to M&A markets; a robust auction market; and, most importantly, very high sale prices have all contributed to the strong run of exits.

The downside of the high valuations that private equity firms have been able to secure in a seller-friendly market is that it has been more difficult for buyout investors to purchase companies at attractive prices.

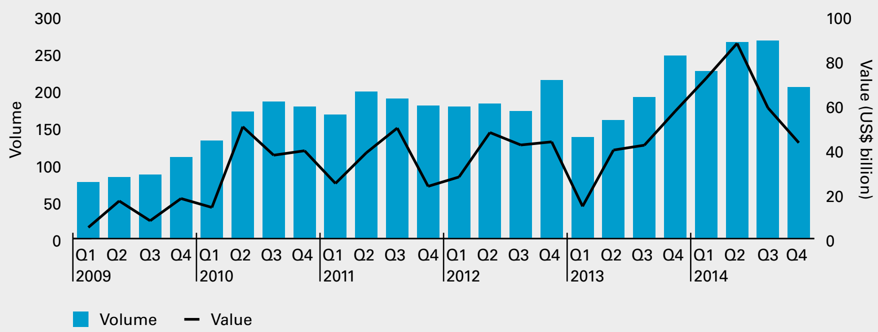
Exit volumes and values have been soaring, but new deal activity has been far more sedate. There were 871 buyouts closed in 2014, an increase of only 14 percent from 2013. The value of buyouts was US$153.8 billion in 2014, lower than the US$159.3 billion recorded in 2013.

While buyout activity is well up from 2009 figures, when there were only 463 buyouts worth US$48 billion, the recovery has been modest when compared to the market for exits. Now that firms have, in some respects, cleared out their portfolios, attention will have to turn to new deals in 2015, which could finally prompt an increase in buyout volumes.

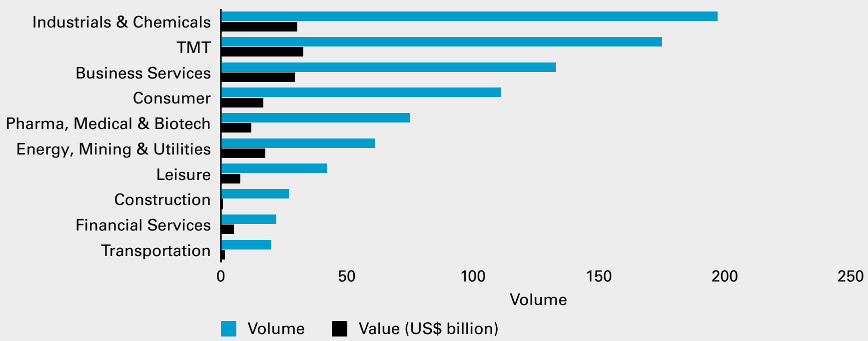
US private equity buyouts, 2009 –2014



US private equity exits 2009 – 2014



US private equity buyouts – top ten sectors 2014



Looking ahead: All eyes on 2015

Looking ahead
US M&A activity should continue thriving into 2015. However, despite an upbeat outlook, dealmakers cannot afford complacency.

The beginning of 2015 has seen stock market volatility and a continued slide in oil prices—at the time of writing, Brent Crude Oil prices were at a six-year low and have seen a drop of 60 percent since the middle of last year.

One major theme of 2014 was the discrepancy between the increases in value and volume. "We note that while aggregate deal value is up substantially, which is creating a lot of the excitement around the M&A market, the fact is that aggregate deal volume has not increased as much. A fall in the number of megadeals in 2015 could affect the momentum built up through the last year," says White & Case partner Morton Pierce.

As dealmakers move into 2015, they would, therefore, do well to remember the following lessons from the year past:

Watch the regulators
Antitrust scrutiny has impacted a number of deals and the US Treasury has tightened the rules around tax inversions, a development that prompted AbbVie to withdraw its bid for Shire Pharmaceuticals. Dealmakers should be following these developments closely.

Stick to strategy
Shareholders have, for the most part, rewarded boards that have pursued transformative deals. This should not, however, be read as a green light to pour cash that has been sitting on balance sheets into a slew of opportunistic deals. Investors will back transactions, but only if they are underpinned by solid deal rationales.

Diversify your acquisition capital
When prices are high, it is worth mitigating risk by using a variety of acquisition capital to fund a transaction. Companies may want to pay with stock to share some of the risk with their targets. And even cash rich corporates may want to use debt to finance at least some portion of their deals, given that debt is widely available and attractively priced.

Do your diligence
The competition for prized assets is likely to be just as fierce in 2015 as it was in 2014. However, the desire to prevail over rivals and get the deal done as quickly as possible should not preclude bidders from doing thorough due diligence on their targets.

While there has been something of a slowdown in the first weeks of 2015, we believe the prospects for dealmaking in 2015 remain positive. However, the real acid test of the US M&A recovery will be whether there is a deepening of the market beyond the megadeals that dominated the headlines in 2014.

"We continue to have a strong US economy and a deal market that is attractive to both domestic acquirers and foreign acquirers. That bodes well for a strong 2015," says White & Case partner Daniel Dufner. "There is an entire well of untapped M&A activity. We hope that in 2015, we will not only see megadeals, but also see activity floating down-market."

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Published in association with Mergermarket

Part of the Mergermarket Group
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