WHITE & CASE

Defying gravity: US M&A H1 2019

A rise in US mega-transactions more than made up for a drop in volume in the first half of 2019


LIBERTY
IN GOD WE TRUST
1985

Foreword

After a drop in activity in the second half of 2018, US M&A has recovered strongly in the first two quarters of 2019, demonstrating the appeal of dealmaking—despite uncertainty

In spite of several quarters of growing uncertainty about macroeconomic headwinds, US M&A deal value grew again in the first half of 2019. Overall value for the first six months of the year was up 9 percent compared to the same period in 2018. And US deal value took up a larger share of global M&A, making up 53 percent of total global deal value, up from 41 percent in H1 2018. US deal volume, on the other hand, was down 21 percent compared to 2018, a record year for deal volume.

This is good news, particularly since global activity declined on both value and volume measures this year. But the future seems more uncertain today than it has in some time, particularly since there are strong reasons for both caution and optimism.

There are some signals warning that we are due for an economic correction, despite a US economy that remains healthy. US Federal Reserve Chairman, Jerome Powell, recently hinted at rate cuts, highlighting that uncertainty over trade policy and weakening global growth continue to have negative implications. Trade troubles persist, particularly with China. An inverted yield curve suggests that the market expects a downturn on the horizon. And, after a lengthy period of frenzied dealmaking, valuations are high.

Yet the US economic backdrop remains favorable, at least for now. Capital markets are at record levels and there is plenty of financing available for companies who need it to fund dealmaking. Private equity firms continue to amass capital to deploy.

Though deal volume has dropped for three quarters in a row, viewed in the longer-term context, activity remains robust.

Whether the second half of the year can sustain the same level of activity as H1 remains to be seen. The year-on-year growth in M&A value suggests that dealmakers still have appetite, as well as the capacity, to execute deals if the strategic rationale makes sense.

John Reiss
Global Head of M&A,
White & Case

Gregory Pryor
Partner
White & Case

Contents

A break in the clouds: M&A in the first half of 2019

The US M&A market delivered a surprisingly robust first half, with total value rising 9 percent year-on-year. Volume, on the other hand, dipped 20 percent

By John Reiss, Gregory Pryor

Defying all odds, US M&A value rose in the first half of 2019. Total deal value climbed 9 percent on the first half of 2018 to US$913 billion, making it the best-performing first half for US M&A on record. Yet, when it comes to volume, the picture is significantly less rosy—there were 2,531 deals in H1, a 21 percent drop over the same period.

On a percentage basis, domestic activity tracked the overall figures fairly closely. Domestic deal volume dropped 22 percent to 2,090 deals, and value rose 8 percent to US$777.3 billion in the first half of the year.

But inbound activity significantly outperformed outbound activity in H1 2019, indicating the US remains a safe place for investment. Though the number of inbound deals fell 16 percent to 441 deals, value climbed 19 percent to US$135.4 billion.

Outbound activity, on the other hand, dropped—value fell 4 percent to US$191.2 billion, while volume dropped 22 percent to 551 deals.

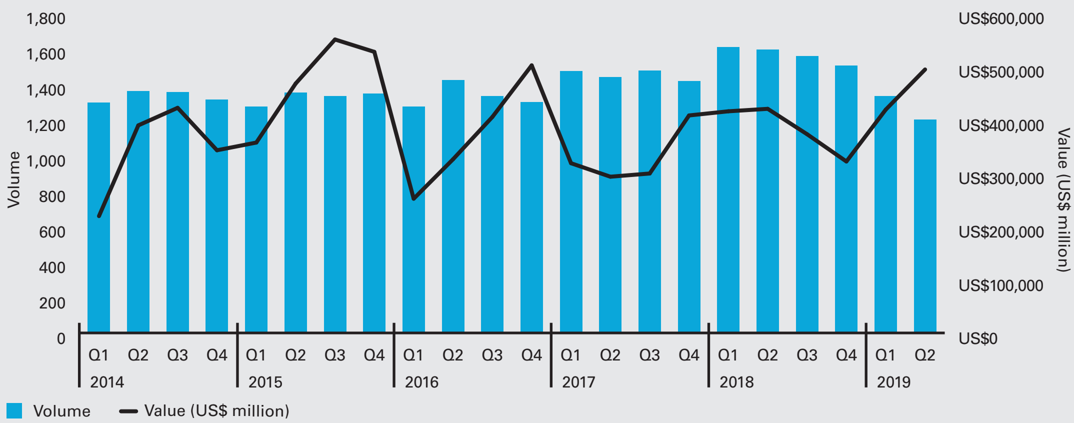
A number of large deals buoyed M&A value during the first half—most notably, Bristol-Myers Squibb's US$89.5 billion (inclusive of net debt) purchase of Celgene.

But even in the megadeal market there has been a divergence between strategic purchasers and private equity investors. While private equity deal value activity has grown quarter-on-quarter in the first half of 2019, the recovery has not been strong enough to match H1 2018's figures.

Corporate deals, by contrast, are still going ahead, most notably in sectors and industries where companies are either under pressure to consolidate or facing disruption and challenges from new entrants and evolving technologies.

This reflects a macro-environment that provides a supportive backdrop for CEOs keen to engage in M&A. The US economy has continued to grow more strongly than many of its peers; the labor market is in good condition; and, though the leveraged finance market showed signs of stress early in the year, tensions

US M&A 2014 – H1 2019



have since eased and financing is available, particularly for good deals. As long as the US economy continues to post healthy growth figures, strategic dealmaking should continue.

That said, there is now some evidence that investor enthusiasm for M&A is beginning to wane. Several of the largest deals announced during the first half of the year met a mixed reception in the markets, with shareholders notably more skeptical about such transactions than in the recent past.

And policy and politics present an increasingly challenging context for M&A, with the Trump administration's ongoing disputes with China—as well as question marks over trade with Mexico and Europe—casting a shadow.

Uncertainty about a possible trade war with China is a particular challenge for dealmakers attempting to build a medium- to long-term business case for transactions. The dispute has already begun to have a direct impact—most notably on Chinese investment into the US, where regulatory scrutiny of such deals has increased significantly.

For now at least, inbound M&A has remained strong, though deal numbers might have been significantly higher if Chinese

Is the US antitrust paradigm shifting?

By George Paul

Prior to his inauguration, President Trump's administration was widely expected to take a more laissez-fair approach to antitrust than its immediate predecessors, but things have turned out differently. The administration's attempts to challenge the merger between AT&T and Time Warner, though unsuccessful following a series of legal defeats, are emblematic of a desire in Washington to reorient antitrust regulation.

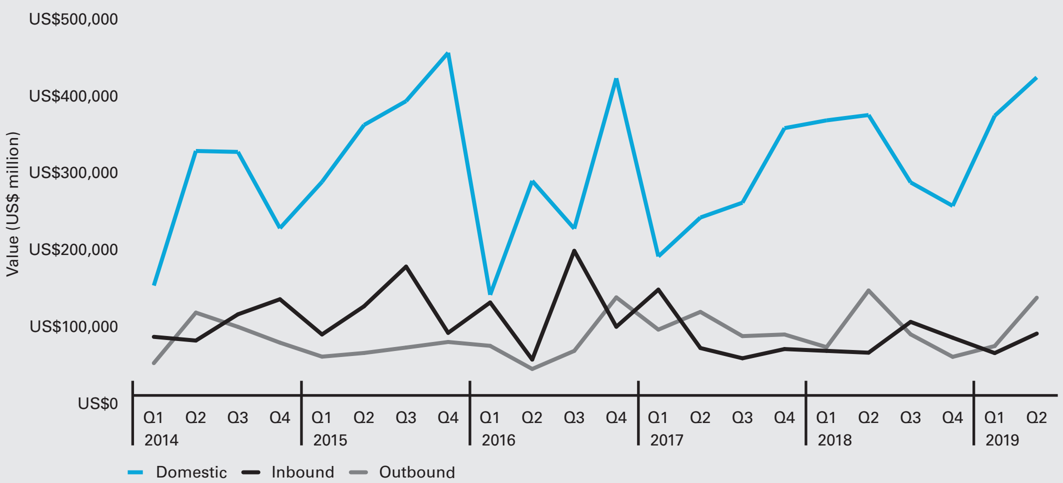
The current framework focuses on the potential for harm to consumers, primarily through the lens of pricing, but an increasing number of policymakers are exploring approaches to antitrust that are based on a broader conception of market power.

The trend has been embraced by leaders on both the right and left sides of the political spectrum. Elizabeth Warren, a prominent Democratic Presidential candidate, is at the center of an increasingly vocal campaign for the break-up of US technology giants. The argument is that there are many ways—including but not limited to pricing—that large companies may leverage their size and influence to manipulate markets in their favor, often at a cost to consumers and society. Some argue that antitrust should be used to address issues related to income inequality, wage growth and unemployment.

These ambitions may require legislative change, and the questions of if, when and how the US might embrace full-blooded regulatory reform remain unanswered. But it is clear that the implications of a more interventionist approach to antitrust are significant for very large businesses considering M&A in any sector—not just the high-profile tech giants.

Businesses now contemplating deals should be conscious of the changing mood. With regulators potentially erecting more antitrust hurdles, large businesses will need to be able to defend their transaction from different types of scrutiny—not just the potential impact on consumer prices.

US M&A: Domestic, inbound and outbound value



Foreign investment under scrutiny

By Farhad Jalinous

International acquirers of US businesses face increasingly tougher regulatory challenges as they seek to get transactions across the finish line, with many more deals—including minority investments—now being evaluated from a national security perspective following reforms to the US inbound foreign direct investment regime, better known as the Committee on Foreign Investment in the United States (CFIUS) review process.

Amid tough rhetoric on protecting US interests, President Trump last year signed into law the Foreign Investment Risk Review Modernization Act (FIRRMA), the first update in more than a decade to the statute that regulates the CFIUS review process. Widely seen as a response to Chinese investment in key US sectors, FIRRMA closes gaps in the law—the reform extends CFIUS's reach in the real estate sector and into minority "non-controlling yet non-passive" investments, for example. Most significantly, under FIRRMA, a pilot program was launched requiring mandatory filings in certain deals involving "critical technologies." The impact has been profound, with foreign investors spending more time evaluating the application of the pilot program to their transactions.

The increased relevance of the CFIUS review process was further highlighted by the continuing tough stance CFIUS took during the first half of the year. In addition to a number of high-profile cases where it put pressure on Chinese acquirers to divest previously acquired businesses, CFIUS also announced its first financial penalty, a US$1 million penalty charged to unnamed parties for repeated violations of a mitigation agreement signed in 2016.

Employment: Incentives grow in importance

By Henrik Patel

Retaining key staff is a crucial challenge in most M&A transactions, particularly in cases when human capital represents a large percentage of deal value.

In this context, the growing legislative backlash against non-compete clauses that are regarded as overly restrictive presents a serious challenge for acquirers. In Massachusetts, for instance, the ability to prevent key staff working for competitors has been significantly diminished at the end of 2018. A number of other states are considering similar legislation. Such legal impediments to the enforceability of non-competes detract from their usefulness as an appropriate retention tool.

As a result, acquirers will have to consider more novel approaches to how to increase retention of key executives in connection with deals.

Succession planning and other social issues of post-acquisition management control are often the key elements of this equation. Getting agreement on who will take which senior roles post-acquisition is a crucial part of any deal negotiation.

Acquirers are also exploring options such as holdback provisions that require key executives to remain with the business for a defined period if they are to receive the full allocation of deal proceeds otherwise due as part of the deal. In the past, sellers have been reluctant to accept holdback provisions, but they are more common and some sellers are slowly embracing them.

buyers had felt more able to pursue investment opportunities in the US.

Elevated risk and anxiety do appear to have had an effect on US companies' appetite for overseas acquisitions, given the significant slowdown in outbound M&A seen during the first half. For corporates pursuing an acquisitions strategy, domestic deals have felt more comfortable in recent months—all the more so given the strength of the US economy relative to that of Europe and Asia-Pacific.

In some sectors, key drivers of M&A remain as strong as ever. In the healthcare market, for example, big pharma continues to view dealmaking as a vital tool for acquiring new drugs, with biotech businesses representing attractive targets. In the technology sector, meanwhile, M&A is often the only way for large companies to cope with the accelerating pace of digital transformation.

Political uncertainty, particularly around the US's trade policies, and valuation anxiety have the potential to act as a brake on dealmaking. Any downturn in the US economy would have an even more significant impact. This is a risk to weigh carefully, given that the yield curve in the bond market continues to be inverted. An inverted yield curve has been a leading indicator of recession risk over the decades, though not all economists accept its inevitability.

Absent a recession, US M&A activity should remain healthy by historical standards in the second half of 2019.

Private equity slows in 2019 as valuations continue to rise

Despite accumulating a vast, historic pile of capital for acquisitions, private equity has moderated its pace of buyouts in the first half of the year

By Oliver Brahmst, Gary Silverman, Raymond Bogenrief

Buyout activity fell 14 percent compared to the first half of 2018, with values totaling US$111.1 billion during the first six months of 2019, while volume fell 19 percent to 608 deals. On the other hand, exit activity fared far better, rising 19 percent in deal value to US$148 billion, though volume fell 15 percent to 505 deals.

Whether the first-half slowdown in private equity buyouts represents the start of a sustained decline in activity or a mere pause for thought remains to be seen. Buyout activity remains high when assessed in a historical context. But the industry may be taking a wait-and-see approach given the possibility of a slowdown in the US economy. The question is how long they can wait—with US$2.4 trillion in dry powder globally, firms are under significant pressure to get deals done.

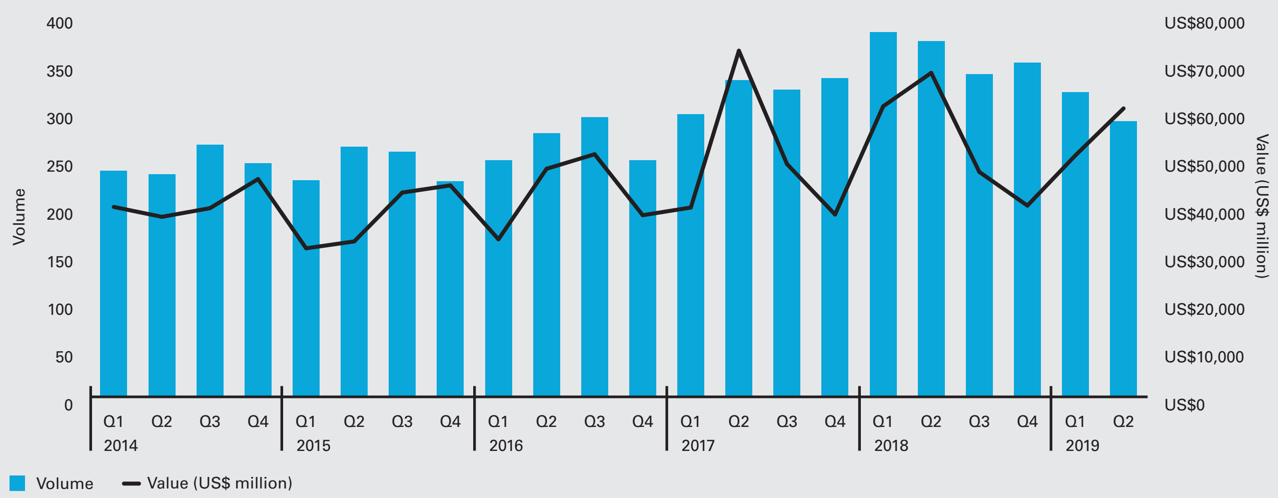
The availability of capital has pushed competition and valuations to exceptional heights, with multiples averaging about 11 times' EBITDA in the US and Europe over the past 12 months, above the level seen prior to the financial crisis. Thus some firms are biding their time, particularly in industries where strategic buyers—able to issue stock to finance high purchase prices and to justify elevated valuations with synergy estimates—are particularly active.

Against this backdrop, activity has skewed toward larger deals in the first half of the year. In the buyout category, the two largest deals of the year so far, Zayo Group's US$14.1 billion acquisition by Digital Colony Partners and EQT, and Ultimate Software's US$11.8 billion acquisition by a Hellman & Friedman and Blackstone consortium, together accounted for nearly a quarter of total deal value. In the exit category, KKR's sale of payments

US $111.1 billion

The value of 608 buyout deals in H1 2019—a 14 percent fall compared to H1 2018

US private equity buyouts 2014 – H1 2019



infrastructure provider First Data to Fiserv for US$38.4 billion accounted for more than a quarter of deal value.

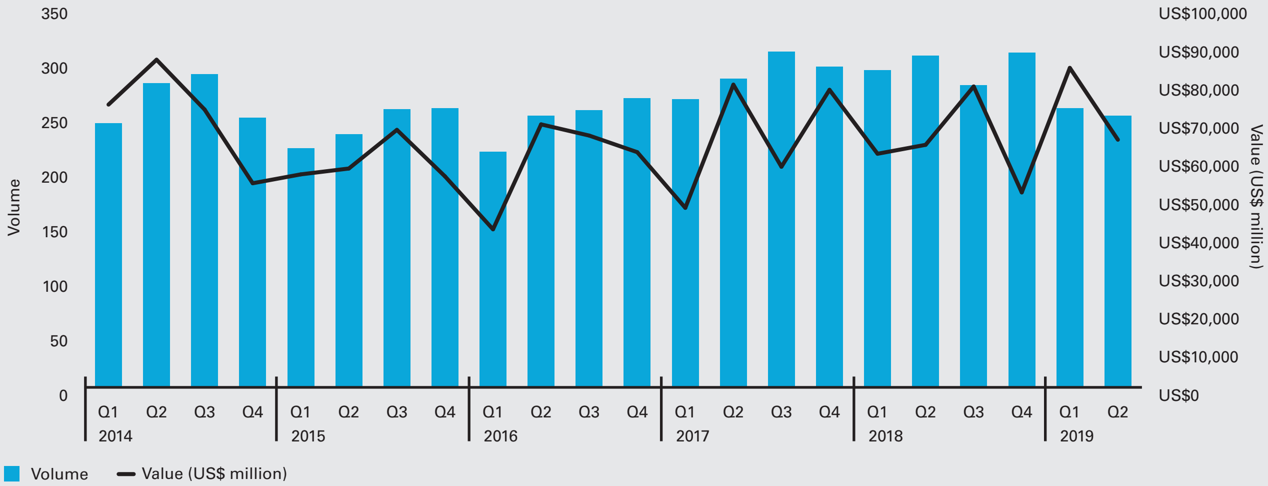
For some firms, the answer has been to try new approaches. The fact that the two largest deals of the year so far were take-private transactions reflects the fact that, with multiples so high among private companies, valuations of publicly listed companies, even at a premium, look more affordable. Alternatively, a growing number of private equity firms are investigating cross-border transactions, seeking out investments in Europe, as well as other jurisdictions, where competition is not so fierce.

Higher multiples have also seen the return of club deals, with buyers pooling resources to access mega-transactions. Such arrangements bring their own challenges—most obviously over who will have strategic control of the business and exit timing—but these look less daunting in a highly valued marketplace. In addition, "new" club deals are also emerging, in which large-cap funds bring in one or two of their largest LPs to underwrite between 25 percent and 40 percent of the equity check. In terms of control, the LP will have minority rights but the large-cap fund will be in charge.

On the exit side, while sales were slower in the first half, heightened expectations of a recession should lead to an increase in activity, as funds seek to sell out of holdings vulnerable to a downturn. We are already beginning to see average holding periods come down in length to approximately four and a half years—and a corollary increase in "quick-flip" exits after fewer than three years.

> "
> **With US$2.4 trillion in dry powder globally, firms are under significant pressure to get deals done.**

US private equity exits 2014 – H1 2019



Sector Watch: Pharma and TMT lead the pack

By John Reiss, Gregory Pryor

HEADLINES

- TMT led the pack in terms of volume in the first half of 2019, with 622 deals, followed by industrials and chemicals, with 439
- By value, PMB led the field, though a single megadeal accounted for more than half of the US$172 billion in total deal value
- Energy came in third in terms of value, even as deal volume fell sharply

The technology, media and telecoms (TMT) industry saw significantly more deals than any other during the first half of the year, racking up 42 percent more transactions than the next busiest sector: industrials and chemicals. These sectors were out in front by some distance, recording 622 and 439 M&A deals respectively during the first half, along with business services (352).

On the value front, the pharmaceutical, medical and biotech (PMB) industry led the way, with 282 transactions totaling just over US$172 billion—though more than half of this total stems from a single deal, Bristol-Myers Squibb's US$89.5 billion purchase of Celgene.

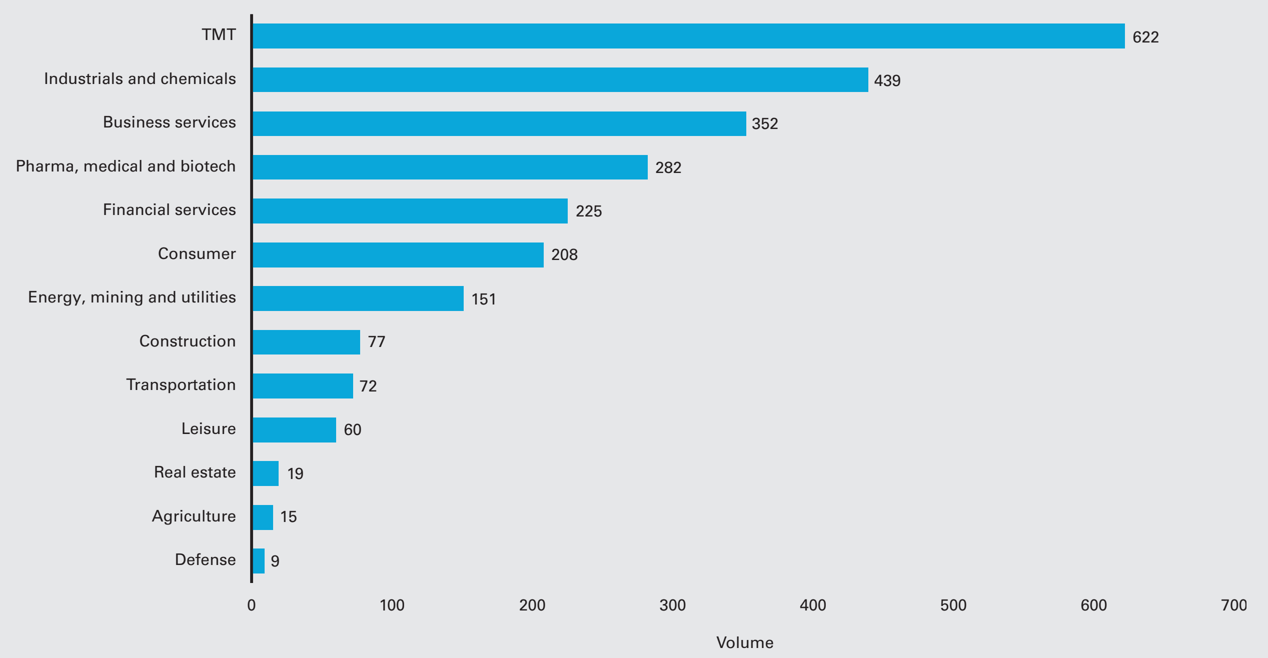
622

Number of deals in the US TMT sector in H1 2019—42 percent higher than the next busiest sector

The TMT sector recorded the second-biggest total deal value during the first half of the year, with US$163 billion of transactions. Energy, mining and utilities ranked third, despite having only seen 151 deals, collectively worth just over US$123 billion.

Business services was the only other sector to post a total deal

US M&A sectors by volume, H1 2019

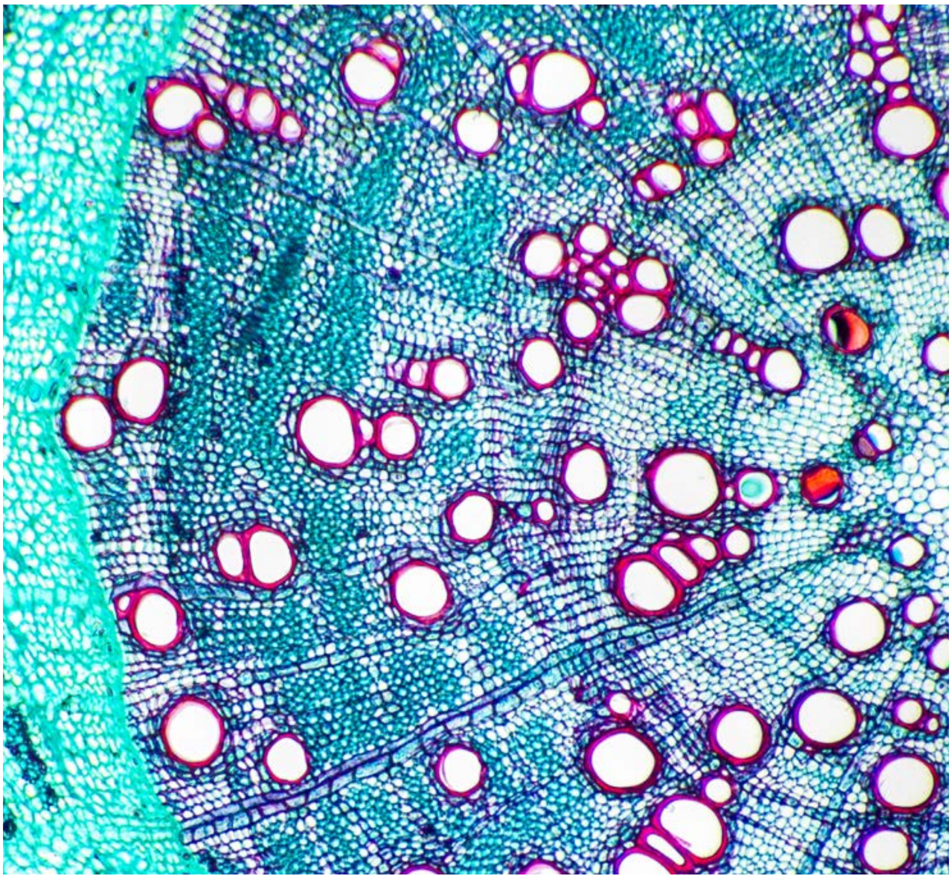


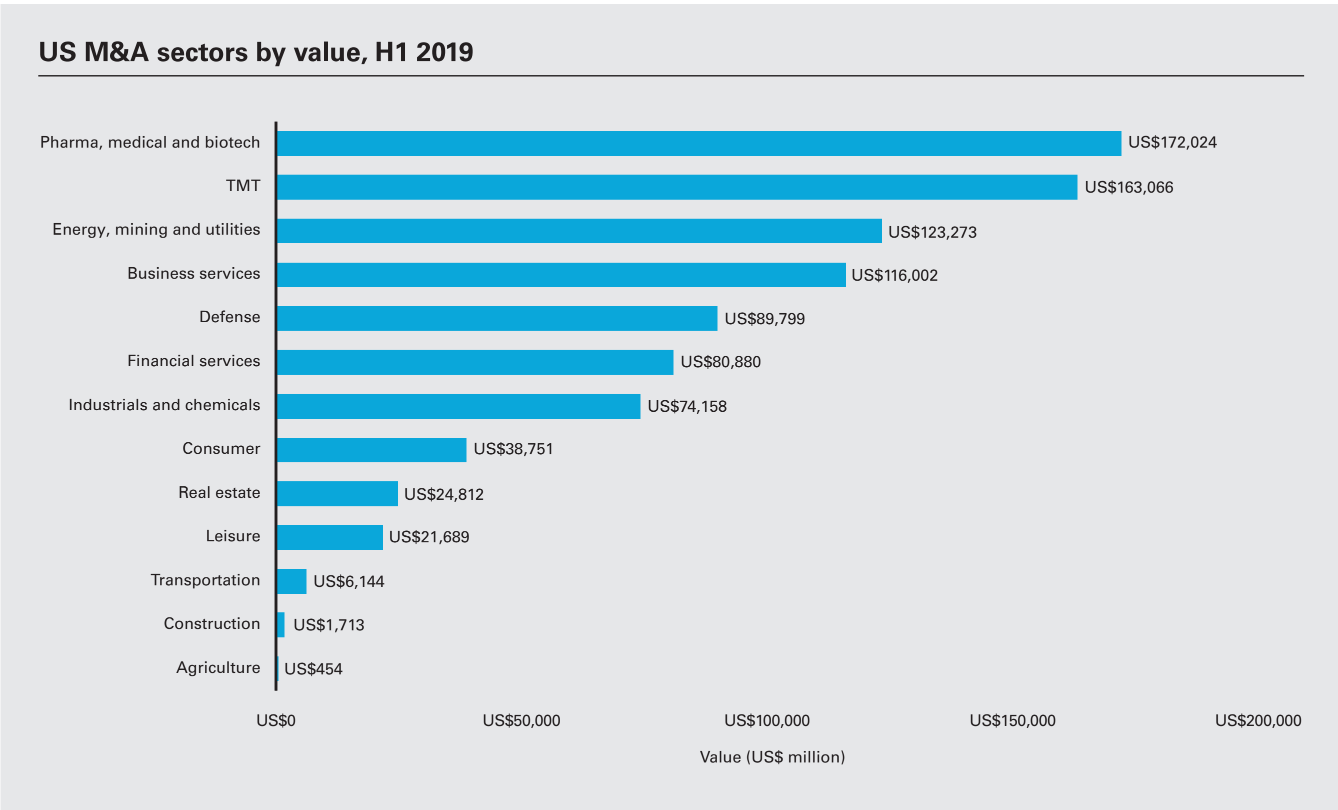
“

Pharmaceutical, medical and biotech industry led the way, with 282 transactions totaling just over US$172 billion.

value of more than US$100 billion during the first half of the year, with transactions collectively worth a little over US$116 billion.

By contrast, the industrials and chemicals sector only posted transactions worth US$74 billion, despite seeing more deals than any industry other than TMT. Financial services (US$80.8 billion from 225 transactions) and consumer (US$38.8 billion from 208 transactions) also posted significant total deal values, with real estate (US$24.8 billion from 19 transactions) further back.





Pharma chases innovation through deals

The need to replenish intellectual property has pushed the pharma industry to the highest-performing sector by M&A value

By Morton Pierce

In the pharmaceuticals, medical and biotech sector, deal value in the first half of the year was up 142 percent to US$172 billion—making it the best-performing sector in terms of value in H1. But volume was down 11 percent to 282 transactions. Much of this increase in value can be attributed to Bristol-Myers Squibb's purchase of Celgene, one of the largest-ever deals in the sector.

The blockbuster US$89.5 billion Celgene deal is indicative of the market. Big pharma is competing fiercely in areas such as immuno-oncology, where breakthrough drugs are now transforming patient outcomes. These treatments have the added attraction of being more difficult for generics firms to replicate when they move off-patent.

It is notable that the third-biggest deal of the year so far, though much smaller, took place in the same segment of the market. Pfizer's US$10.7 billion purchase of Array BioPharma will broaden its cancer drugs offering and strengthen its biopharma business.

Elsewhere in the industry, consumer health remains an interesting segment, with a number of large pharmaceutical companies divesting their businesses in this area of the market. Such deals reflect a desire to focus on the core business, particularly in the face of scrutiny from activist investors urging companies to concentrate their efforts where the most value is being generated.

Looking forward, there is now scope for increased M&A activity among firms seeking technological innovation. One area of interest, for example, is the increasing use of technology to improve decision-making during the clinical trials process. Enhanced use of technology will continue to be an important theme throughout the sector.

Another possibility is further M&A activity at a more strategic level, including deals designed around the principle of vertical integration as businesses seek to stay ahead of the market. Transactions that combine both retailer and payer, for example, provide clear opportunities.

Potential headwinds include increased political volatility, uncertainty around healthcare reform and the prospect of regulatory change, together with any notable deterioration in the broader economy.

US $172 billion

The value of 282 deals targeting the US pharma sector in H1 2019

142%

Percentage increase in deal value of US pharma M&A compared to H1 2018

Top pharma & healthcare deals H1 2019

1

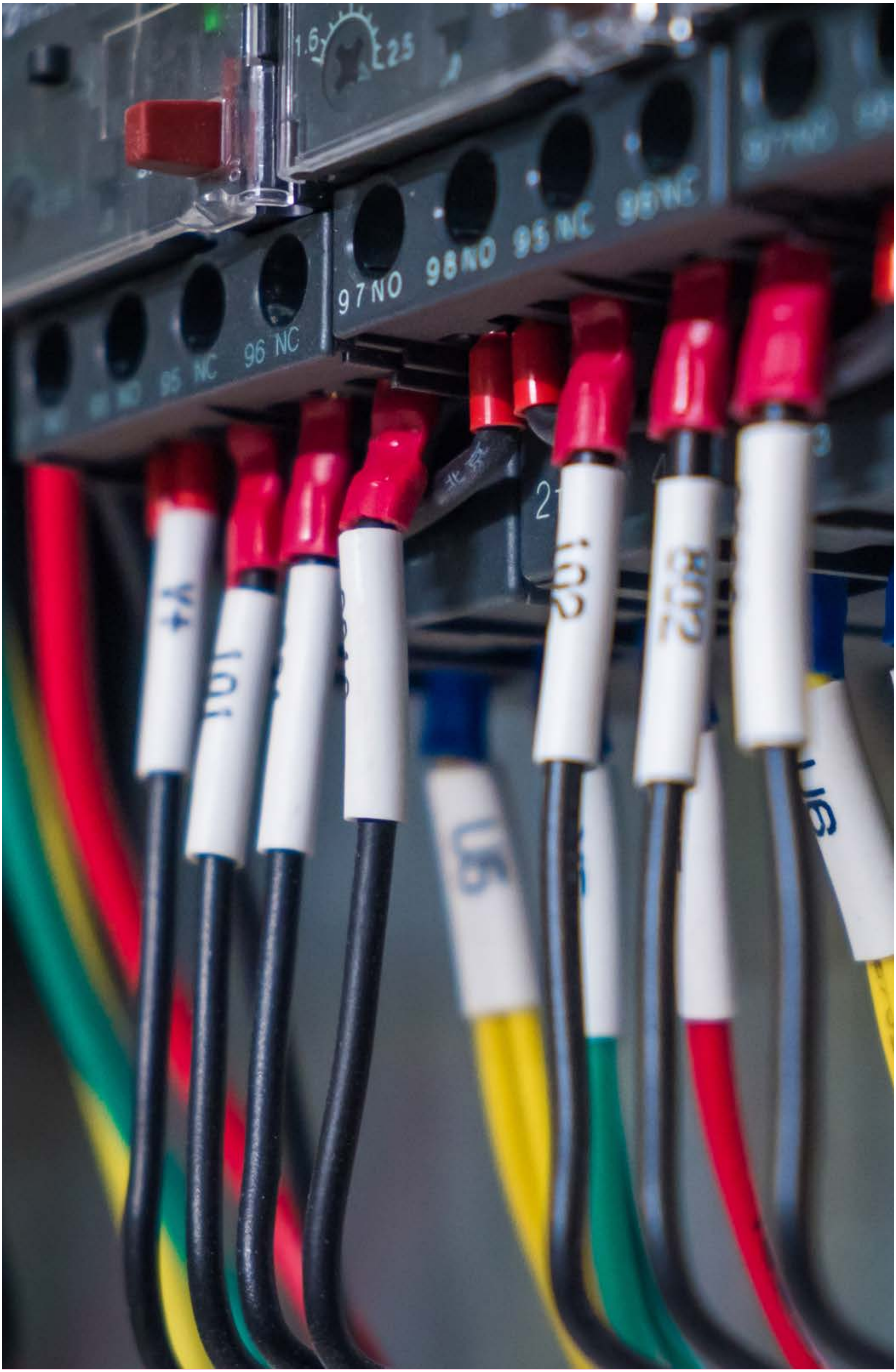
Bristol-Myers Squibb bought Celgene for **US$89.5 billion**

2

Danaher Corporation bought GE Healthcare Life Sciences for **US$21.4 billion**

3

Pfizer Inc. bought Array BioPharma, Inc. for **US$10.7 billion**


1.6
2.5
97 NO
98 NO
95 NC
96 NC
95 NC
96 NC
Y+
101
102
502
U6

Technology dealmaking stays buoyant

H1 2019 has seen deal value continue to climb in technology M&A, as digital disruption overtakes segments of the market such as fintech and Big Data

By Arlene Arin Hahn

While the first-half total of 505 transactions in the technology sector represents a 16 percent decrease in volume compared to the same period of 2018, these deals were collectively worth US$123.4 billion, a 61 percent increase on the first half a year ago. The top end of the M&A market, boosted in particular by the US$25.7 billion purchase of Total System Services by Global Payments, has remained active.

That reflects a natural extension of the M&A trajectory seen in the tech sector over the past two to three years. In the first phase of disruption, M&A volumes were boosted by the desire of private equity firms and industry bidders alike to acquire new entrants, secure key talent and skills, and remain competitive. The sector may now be moving into a second phase, in which a wave of consolidation brings smaller numbers of larger transactions as organizations seek scale.

Global Payments' purchase of Total System Services provides a good example of this trend, with payments technology companies now seeking to consolidate in order to fend off competition from new fintech entrants to the industry.

The enterprise software segment is another area to have seen significant activity. The sector's leaders are keen to offer a broader-based product range to help businesses transition to cloud computing—and make the best of the switch. Tableau—which was acquired this year by Salesforce for US$15 billion—is one such firm, developing software tools to make it easier for workers not trained in data science to create visualizations out of raw data.

Valuations in the tech sector remain strong. While there are some headwinds on the horizon, including increased regulatory scrutiny for technology-driven deals, competition for assets still persists. In addition to tech businesses seeking consolidation, bidders include non-tech players seeking to acquire new capabilities as their industries transform, and private equity firms, which still have dry powder at their disposal.

US $123.4 billion

The value of 505 deals targeting the US tech sector in H1 2019

61%

Percentage increase in tech M&A value compared to H1 2018

Top tech deals H1 2019

1

Global Payments Inc. bought Total System Services Inc. for **US$25.7 billion**

2

Salesforce.com bought Tableau for **US$15 billion**

3

Hellman & Friedman – Blackstone consortium bought Ultimate Software Group Inc. for **US$11.8 billion**


$1.29
$1.29
$1.39

Retail M&A falls as sector migrates online

M&A activity in the retail sector fell sharply during the first half of 2019, as uncertainty and digital disruption continue to put pressure on the sector

By Gary Silverman

There were just 54 deals in the retail sector during the first half of 2019, compared to 84 transactions that took place during the same period of 2018. Deal values fell even further than volume, down 43 percent to US$9 billion.

The industry continues to see a shake-out as spending migrates from physical stores to online, taking its toll on traditional chains that have not been able to embrace digital transformation with sufficient speed. Already in the first four months of this year, retailers announced that 5,994 stores would close in the US, more than the number of stores closed in all of 2018, according to retail industry research firm Coresight Research.

This disruption is now having an impact on M&A. The largest deal in the first half by some margin, ESL Investment's purchase of Sears out of bankruptcy, followed the collapse of the iconic retailer in the face of tough competition, including from online rivals. Further activity around distressed assets is likely in the second half of the year and beyond.

The rise of e-commerce is also driving a different kind of deal, as leading players target new markets, or team up with bricks-and-mortar chains.

Amazon's purchase of Whole Foods two years ago continues to be closely monitored as the online retailer is reportedly striving to prove its Prime customer base is the right market for its new subsidiary, while also apparently contemplating price cuts to drive sales increases.

US $9 billion

The value of 54 deals targeting the US retail sector in H1 2019

43%

Percentage decrease in retail M&A value compared to H1 2018

Similarly, Walmart's purchase of a majority stake in Flipkart last year is an example of a leading bricks-and-mortar retailer diving into both e-commerce and overseas markets. India's largest online retailer also offers an invaluable source of expertise on technological innovation, particularly in artificial intelligence. If Walmart can make a success of the deal, competitors may want to pursue similar transactions.

On valuations, retail businesses have continued to attract premium prices, both from strategic buyers and private equity firms, which have often taken on significant debt to fund transactions.

That leaves little room for error in the successful execution of the value plan for these deals—and could leave buyers vulnerable in the event that any significant downturn in the US economy affects the sector, especially where significant leverage is employed.

However, for now at least, the backdrop for the sector remains strong, with an economic environment that is generally supportive of consumer spending (which grew 3.2 percent year-on-year as of May 2019, according to the National Retail Federation, a trade association).

Top retail deals H1 2019

1

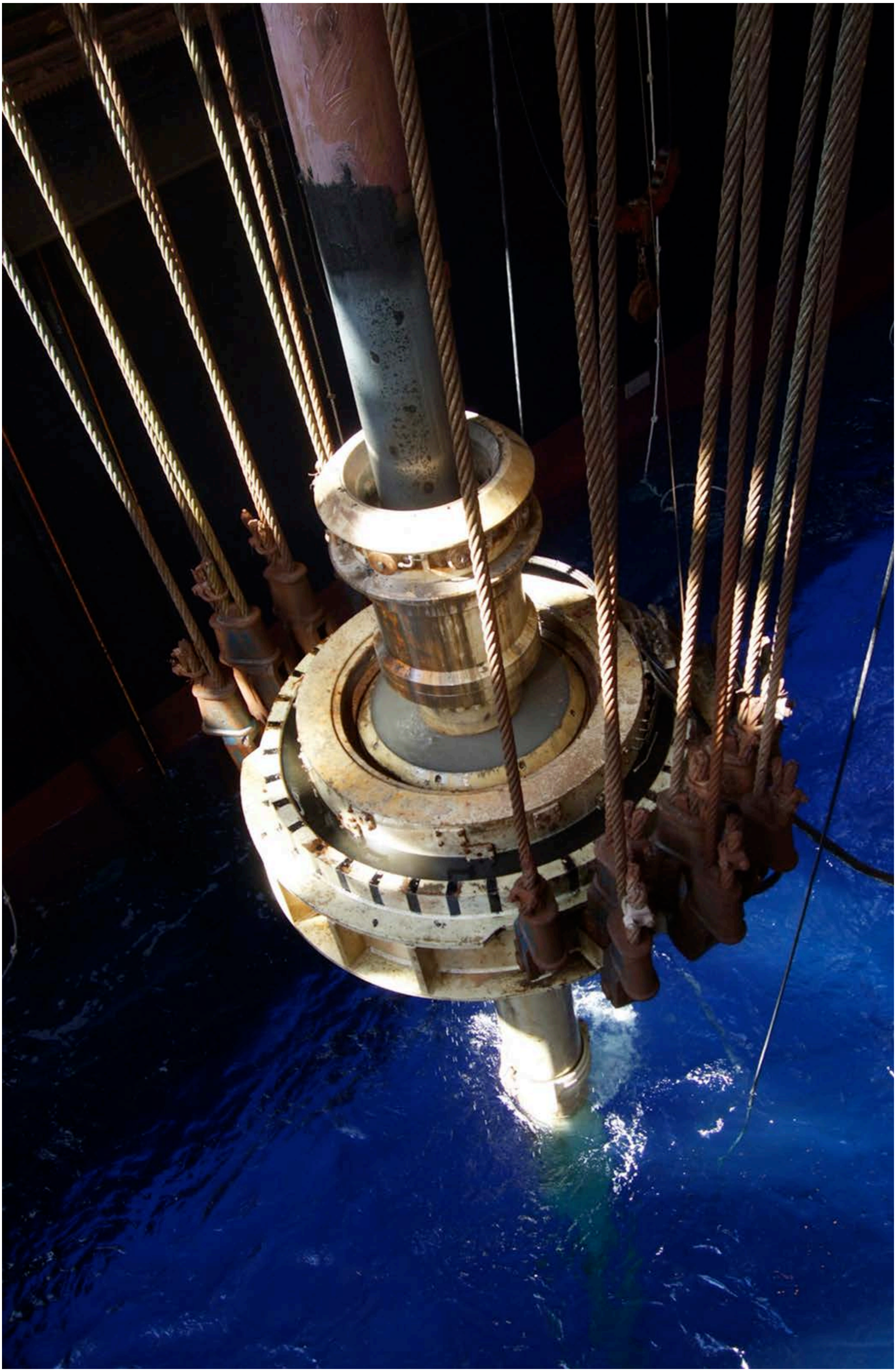
Sears bought ESL Investments, Inc. for **US$5.2 billion**

2

Cura Partners bought Curaleaf for **US$1.1 billion**

3

Apollo Management bought Smart & Final Stores for **US$1.1 billion**



Megadeals drive oil & gas M&A

Concerns about the price of oil have left the industry reluctant to strike deals, bringing down volume and value in H1

By Steven Tredennick

The oil & gas sector posted M&A transactions worth a total of US$103 billion during the first half of the year, down 9 percent on the same period in 2018. Deal volume fell 44 percent to 90 deals.

The largest deal of the first half of the year, Occidental Petroleum's US$54.4 billion purchase of Anadarko, accounted for more than half of deal value.

Low deal volume might be expected given the relatively narrow—and moderate—range at which oil & gas prices traded in the first half of the year. This has given rise to an environment where returns are constrained, small and medium-sized businesses in the sector have not been able to attract sufficient capital to pursue M&A—and publicly listed companies have come under pressure from investors to return what spare capital they do have.

Meanwhile, oil majors with strong balance sheets have sought opportunities to consolidate, particularly in areas where there is potential for synergies with their existing assets. New technologies with the potential to increase the efficiency of production have also attracted particular interest.

Bouts of volatility are to be expected in the short to medium term—not least in the face of geo-political uncertainties and tensions—but the global economic backdrop does not suggest any significant increase in demand for oil & gas is imminent.

9%

Percentage decrease in deal value compared to H1 2018

US $103 billion

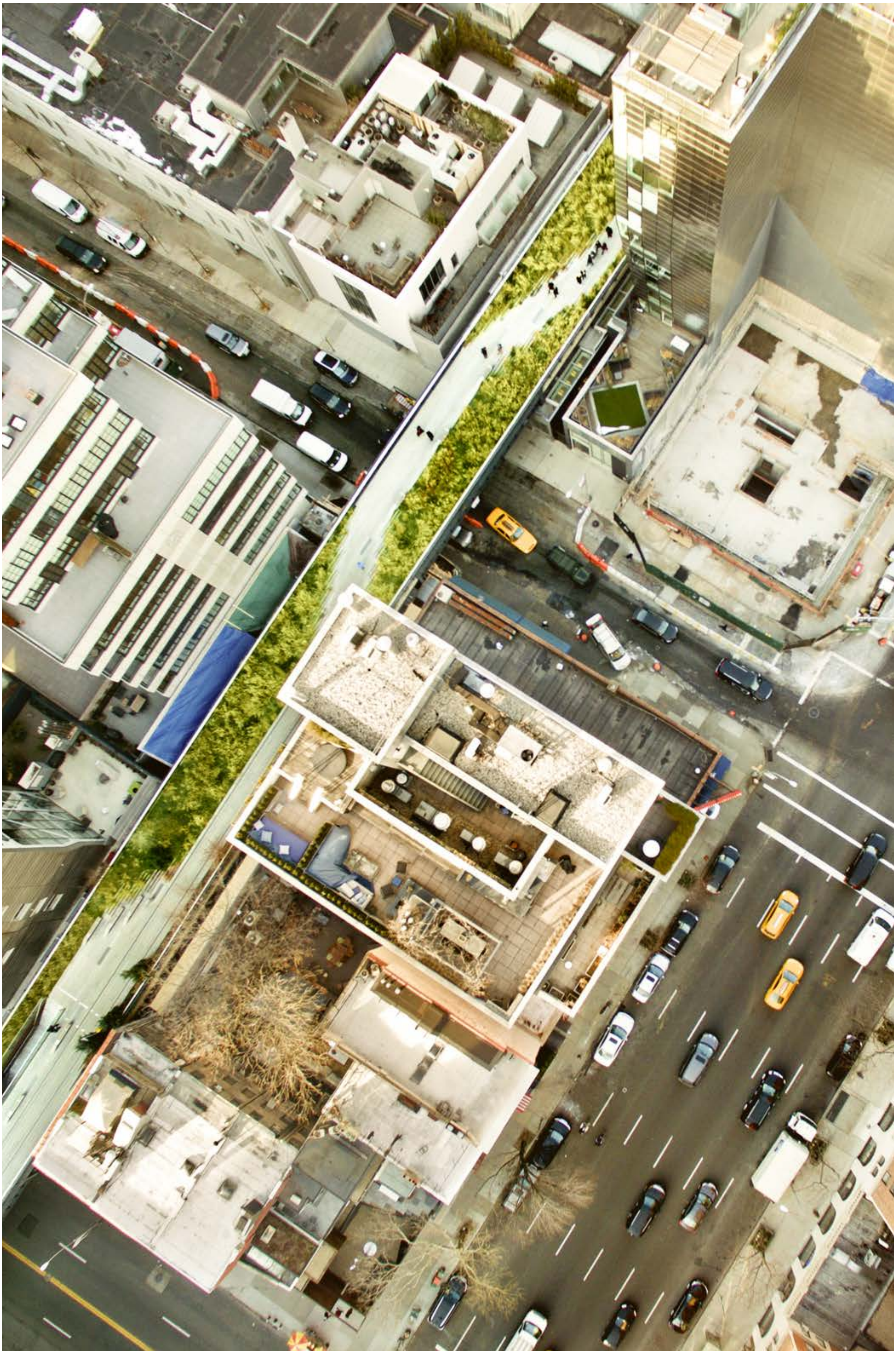
The value of 90 deals targeting the US oil & gas sector in H1 2019

Moreover, the shift away from carbon-intensive energy around the world may limit the potential for increased demand. While US oil businesses are under less pressure than their European counterparts to begin investing in renewables, they will nonetheless be affected by the impact of any long-term shift.

In this context, further consolidation at the larger end of the market is likely, while the potential for smaller deals will be more constrained. A silver lining—the largest transactions are likely to prompt further M&A as businesses review their portfolios; divestments of non-core and overlapping business lines often follow mega-mergers.

Top oil & gas deals H1 2019

1. Occidental Petroleum bought Anadarko for **US$54.4 billion**
2. MPLX bought Andeavor Logistics for **US$10.3 billion**
3. IFM Investors bought Buckeye Partners for **US$10.2 billion**



Real estate M&A drops, but hopes are higher for H2

After a standout 2018, real estate M&A has dropped significantly in the first half of 2019, but segments of the market such as logistics and hotels have remained attractive

By Eugene Leone, David Pezza

There were 19 real estate M&A transactions collectively worth US$24.8 billion during the first half of 2019, representing a 24 percent fall in deal volume and a 53 percent decline in value compared to the same period of 2018.

The comparison is skewed somewhat given that the first quarter of 2018 recorded the highest total quarterly M&A deal value in real estate since 2009. Nevertheless, the sector has experienced a significant slowdown so far this year.

This is a consequence of challenging sentiment in the retail sector, where bricks-and-mortar stores continue to suffer at the hands of online competitors. It also partly reflects the broader anxiety around asset prices seen at the end of 2018 and in early 2019, given stock market setbacks in December. The subsequent recovery in the stock market then led to a modest quarter-on-quarter rise in real estate deal values, from US$8.7 billion in Q1 to US$16.2 billion in Q2.

Nevertheless, there are reasons to remain optimistic about real estate M&A. The desire for income-producing investments in a low-interest-rate environment remains strong, setting the tone in an asset class that has become increasingly important for institutional investors. Net asset values are trading at close to stock prices in most sub-sectors of the market—the exception being retail—but not at premiums, providing a supportive backdrop for acquisitions.

US $24.8 billion

The value of 19 deals targeting the US real estate sector in H1 2019

24%

Percentage decrease in volume of US real estate M&A compared to H1 2018

It is also the case that some sectors of the market have held up much more strongly than was previously expected. Park Hotels' purchase of Chesapeake Lodging Trust, the third-biggest real estate deal of the year so far, comes at a time when hotels continue to post high occupancy rates.

Elsewhere, industrial real estate remains highly attractive, with the e-commerce sector struggling to secure the warehousing and distribution infrastructure it requires to support its pace of expansion. Blackstone's US$18.7 billion acquisition of the US assets of GLP is a good example of a deal driven by this theme.

Meanwhile, REITs offer exposure to a physical asset class in the event there is a flight to safety among investors concerned about recession. And the dry powder held by private equity offers further support for real estate M&A, providing ready buyers for distressed assets, in particular, and smoothing out volatility in the cycle.

Top real estate deals H1 2019

1

Blackstone Group L.P. bought GLP Pte. Ltd (US Logistics Assets) for **US$18.7 billion**

2

Ivanhoé Cambridge bought IDI Logistics for **US$3.5 billion**

3

Park Hotels & Resorts bought Chesapeake Lodging Trust for **US$2.6 billion**

Three key M&A decisions from Delaware courts

The first half of 2019 saw several decisions from the Delaware courts that will affect M&A dealmaking

By Daniel Kessler

Aruba: Supreme Court awards "deal price less synergies" in closely watched appraisal case

Rejecting the Chancery Court's use of unaffected market price, the Delaware Supreme Court awarded stockholders seeking appraisal in connection with Hewlett-Packard Company's 2015 acquisition of Aruba Networks, Inc. US$19.10 per share—a price based on the 2015 deal price minus synergies arising from the transaction. The Supreme Court's decision confirms the continuing importance of deal price in appraisal proceedings.

The Chancery Court had previously determined the fair value of Aruba's stock to be its 30-day average unaffected market price of US$17.13 per share—a significant discount from the US$24.67 per-share deal price paid in the 2015 transaction. The Chancery Court held that recent appraisal decisions by the Supreme Court in connection with the acquisitions of computer maker Dell Inc. and payday lender DFC Global Corp. endorsed using market price as an indicator of fair value when shares of the subject company trade in an efficient market.

In reversing the Chancery Court's decision, the Supreme Court emphasized that, for purposes of appraisal, the subject company should be valued "as an operating entity…but without regard to post-merger events or other possible business combinations." As a result, any appraisal award must exclude any value the selling company's stockholders would receive because a buyer intends to operate the subject company as part of a larger enterprise. Applying this going-concern standard, the Supreme Court found that the Chancery Court incorrectly dismissed deal value less synergies as an indication of fair value because the Chancery Court believed it needed to make additional deductions from the deal price for unspecified "reduced agency costs." According to the Supreme Court, the Chancery Court's view had no basis in the record. In particular, the Supreme Court noted that, unlike a private equity transaction, the HP/Aruba acquisition would not replace Aruba's public stockholders with a concentrated group of owners but simply swap out one set of public stockholders for another. According to the Supreme Court, "HP's synergies case likely already priced any agency cost reductions it may have expected."

The Supreme Court also made clear that the recent appraisal decisions in Dell and DFC do not compel reliance on unaffected market price in determining fair value. While the price a stock trades at in an efficient market is an important factor, a market price further informed by the due diligence efforts of arm's-length buyers, with access to confidential non-public information, to learn more about the company they are buying "is even more likely to be indicative of so-called fundamental value." Going forward, parties should expect deal price less synergies to receive considerable weight in appraisal proceedings absent deficiencies in the deal process.

Olenik: Further guidance for controller transactions

The Supreme Court provided further guidance on how to obtain the benefit of business judgment rule treatment (and avoid the more stringent "entire fairness" standard) in connection with controlling stockholder transactions. The Supreme Court had previously held that the deferential business judgment rule applies to a controlling stockholder transaction if such transaction is conditioned "ab initio" upon the approval of the informed vote of a majority of the minority stockholders and upon the approval of an independent committee of directors (*Kahn v. M&F Worldwide Corp. (MFW)*). In late 2018, the Supreme Court clarified that MFW's "ab initio" requirement would be satisfied if the required conditions were in place prior to any "substantive economic negotiations" (*Flood v. Synutra*).

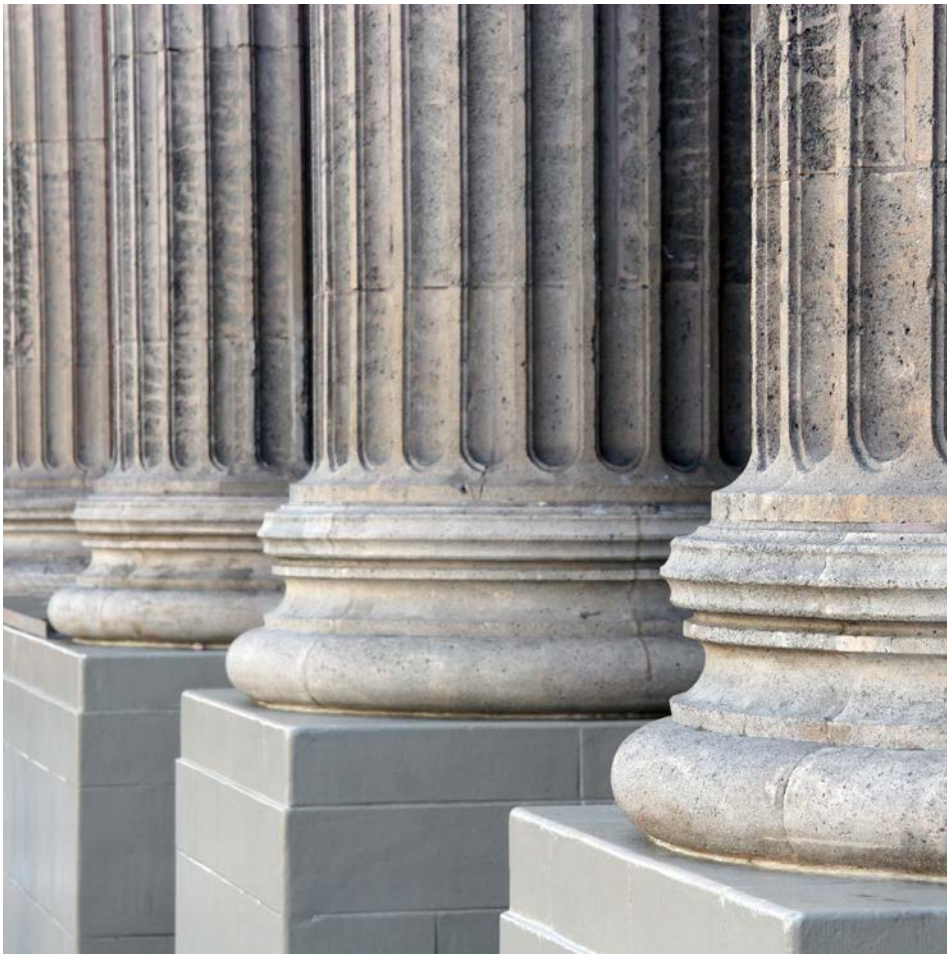
In the April 2019 case of *Olenik v. Lodzinski*, the Supreme Court provided further guidance on when substantive economic negotiations begin. The Chancery Court had previously dismissed a challenge by Olenik, a stockholder of Earthstone Energy, Inc., to a business combination between Earthstone Energy and Bold Energy III LLC on the basis that MFW's protections applied and the transaction was subject to the business judgment rule. The Supreme Court reversed, finding that the plaintiff had pled facts supporting a reasonable inference that the MFW requirements were not in place before substantive economic negotiation took place. While some early interactions between the parties could be fairly described as preliminary, the Supreme Court found that, for purposes of dismissal at the pleadings stage, the preliminary discussions transitioned to substantive economic negotiations "when the parties engaged in a joint exercise to value Earthstone and Bold." According to the Supreme Court, these valuations "set the field of play for the economic negotiations to come." Since the MFW conditions were not in place prior to these substantive economic discussions, the Supreme Court held that the complaint should not have been dismissed. Based on this most recent case, controlling stockholders hoping to obtain business judgment treatment should carefully monitor the nature of any discussions held prior to imposing the protective MFW conditions.

RSI: Protecting attorney-client privilege

In 2013, the Chancery Court held that, following a merger, all assets of a target company, including privileges over pre-merger attorney-client communications, transfer to the surviving company unless the seller takes affirmative action to prevent such transfer (*Great Hill Equity Partners IV, LP v. SIG Growth Equity Fund I, LLLP*). In *Great Hill*, the sellers neither included language in their merger agreement preserving their privilege nor prevented the surviving company from taking actual possession of the communications. As a result, the Chancery Court held that the sellers had waived their ability to assert privilege.

The *Great Hill* decision encouraged sellers to use their contractual freedom in order to avoid waiving attorney-client privilege in connection with a merger transaction. In the recent case of *Shareholder Representative Services LLC v. RSI Holdco, LLC*, the sellers did just that in connection with the sale of Radixx Solutions International, Inc. The applicable merger agreement contained an express provision that 1) preserved any privilege attaching to pre-merger communications, 2) assigned to the sellers' representative control over those privileges, 3) required all parties to take steps necessary to ensure that the privileges remained in effect and 4) prevented the buyer from using or relying on any privileged communications in post-closing disputes against the sellers.

Despite this provision, the buyer, in a post-closing dispute with the sellers, sought to use approximately 1,200 pre-merger emails between Radixx and its counsel contained on computers and email servers acquired in the merger. Because the sellers did not excise or segregate the privileged communications from the computers and email servers transferred to the surviving company, the buyer argued that the sellers waived the privilege. The Chancery Court rejected the buyer's argument. Importantly, the Chancery Court noted that the merger agreement provision covered any privileged communication prior to the Closing Date. Thus, even if the sellers waived privilege post-closing, the merger agreement still prohibited the buyer from using the communications against the sellers. The Chancery Court also noted that requiring the sellers to take action to preserve privilege would undermine the guidance of *Great Hill*, which had encouraged parties to negotiate for contractual protections. By enforcing such a provision, the Chancery Court reminds parties of the importance of clearly stating how pre-merger communications will be treated following a transaction.



SEC proposal would ease burden of certain financial disclosures on public companies

Proposed revisions to current financial statement disclosure requirements for business acquisitions and dispositions would simplify compliance while ensuring investors get the information they need

By Michelle Rutta

In May 2019, the Securities and Exchange Commission (SEC) proposed amendments to its rules governing disclosure of financial statements by public companies or in initial public offerings in connection with significant business acquisitions and dispositions. When a public company acquires or disposes of a business that is "significant," it may have to disclose audited financial statements and pro forma financial statements. Preparing these financial statements may be time-consuming and expensive and require various parties to cooperate, which could affect the overall transaction timeline. The proposal is part of the SEC's ongoing initiative to improve the information investors receive, facilitate access to capital, and reduce complexity and compliance costs.

Amendments to "significance" tests

Generally, the more significant the acquired business, the greater the disclosure required. Significance is determined by applying three tests, the "Investment Test," the "Asset Test," and the "Income Test", and an acquired business is considered significant if it exceeds a threshold under any of three tests, two of which are proposed to be substantively changed.

- **Investment Test.** Currently, this test compares the purchase price of the acquisition to the value of the filer's consolidated total assets. The proposal would replace "total assets" with the "aggregate worldwide market value" of the filer's common equity (i.e., its total market capitalization). This approach would reflect the "fair value" of the filer more effectively than using the value of a company's total assets, which is not reduced by the value of its liabilities.

- **Income Test.** Currently, this test compares the acquired company's income from continuing operations before taxes with that of the filer. By focusing only on income, which can include non-recurring or infrequent expenses, gains or losses, this test can produce anomalous results. To address this, the proposal would split the test into two components: (i) a revenue component, which would compare the revenues of the acquired business and the filer, providing some relief to filers with little or negative net income, and (ii) an income component, which would be amended to use income from continuing operations after taxes, allowing companies to use line items directly from their financial statements. If the filer and the acquired business have recurring annual revenues, the acquired business must meet both components, and the lower of the two would be used to determine the significance level. If not, the income component would apply on its own.

The SEC also proposed amendments to the disposition threshold. Currently, financial statements are required if a disposed business exceeds 10 percent significance. The proposal would raise the threshold to 20 percent, in line with the minimum acquisition threshold.

If implemented, these changes would, among other things, eliminate the need for financial statement disclosure in certain circumstances by defining "significance" to more accurately reflect the relative economic impact of the acquisition on the filer, and reduce the burden on companies with low or negative net income for whom acquisitions often qualify as "significant" under existing rules.

More flexibility to account for benefits in pro forma financial statements

Under existing rules, pro forma financial statements do not generally include the forward-looking benefits of a transaction. The proposal would allow management to present, in a separate column, adjustments detailing a transaction's potential operational benefits and synergies from integration, such as the effect of closing facilities, discontinuing product lines, terminating employees, and executing new

or modifying existing agreements. This column would include both recurring and non-recurring impacts. Each such adjustment would require disclosure of material uncertainties, underlying material assumptions, material resources required and the anticipated timing.

The proposed revisions will allow public companies to better make the case to investors for pending acquisitions with detailed synergy disclosure. However, this disclosure will require additional judgment and analysis by management, and may increase preparation time. The new category of adjustments also could expose issuers and other offering participants in capital markets transactions to potential liability for forward-looking information that relies on judgments by management and estimates that are inherently uncertain.

Although the ultimate outcome of these proposed rule changes has yet to be determined, the proposal represents a clear willingness on the part of the SEC to ease the burden faced by many public companies in complying with financial disclosure requirements for acquisitions and dispositions, while continuing to encourage the flow of material information to investors.

“

The proposal is part of the SEC's ongoing initiative to improve the information investors receive, facilitate access to capital, and reduce complexity and compliance costs.

Can the good times last? Four factors shaping M&A in the second half of 2019

After a record-breaking 2018, the first half of this year has US M&A value rise even further

By John Reiss, Gregory Pryor

Positive drivers of M&A, including the strength of the US economy, the availability of financing and the strategic imperative to consolidate or transform for many corporates have underpinned transactions.

However, concerns about the possibility of an economic slowdown, the US's deteriorating relations with China, and elevated valuations could, moving forward, all prove to be restraining forces on M&A.

Will the pace of M&A continue during the second half of 2019 and beyond? The answer will depend on a multiplicity of factors, but four are particularly significant.

1

Can the US defy the economic pessimists?

The yield curve for 10-year US Treasury bonds has been inverted for much of this year, meaning that investors expect lower interest rates in the future than today. In the last 60 years, an inversion of this kind has been followed by a recession in every case except one.

A recession would clearly be difficult for the M&A market, dampening the enthusiasm of buyers and prompting a rush to exit among private equity firms, particularly those that bought at elevated valuations. The extent to which the US is able to dodge what the bond market appears to see as an almost inevitable downturn will therefore be crucial—though a recession could also create opportunities.

2

Will the Trump administration step back from trade wars?

President Trump's ongoing approach to trade negotiations with the Chinese—and the possibility of escalation in trade tensions with Mexico—are unnerving the M&A market. Without reassurance that solutions can be found to these disputes, strategic acquirers in the US will be reluctant to commit to transactions, whether domestic or cross-border. Inbound M&A will also suffer, as buyers of US assets fear increased scrutiny.

Any suggestion, meanwhile, that the President is prepared to take a step back from a protectionist agenda—and to do a deal with China—would give the M&A market the certainty that it craves, providing a boost to activity.

3

Will shareholders sanction more megadeals?

Deal volumes fell despite the rise in deal value, with megadeals in sectors such as healthcare and technology seemingly immune to the anxiety seen elsewhere in the M&A market. However, even these deals were given a much more hostile reception by shareholders than similar transactions a year ago. CEOs are finding it increasingly difficult to persuade the markets to back their acquisition strategies.

Shareholder skepticism about deals may persist or increase if anxiety about recession and protectionism continues.

Executives will become more reluctant to pursue deals in the knowledge that they may face a battle to secure the backing of their investors.

4

Can private equity find a way to invest record amounts of dry powder?

The record financial firepower that private equity firms currently have at their disposal could underpin a recovery in M&A activity—but only if firms can be persuaded to put this dry powder to work. While valuations remain at current elevated levels, the private equity sector will resist the pressure to spend its cash, particularly if the chance of a recession increases.

There will be new opportunities—expect to see more club deals and international acquisitions, for example—but having raised record funds, the private equity sector is wary of disappointing its investors.

Global

John M. Reiss
Partner, New York
T +1 212 819 8247
E jreiss@whitecase.com

Americas

Chang-Do Gong
Partner, New York
T +1 212 819 7808
E cgong@whitecase.com

Gregory Pryor
Partner, New York
T +1 212 819 8389
E gpryor@whitecase.com

EMEA

Darragh Byrne
Partner, Frankfurt, Stockholm
T +49 69 29994 1433
E darragh.byrne@whitecase.com

Allan Taylor
Partner, London
T +44 20 7532 2126
E ataylor@whitecase.com

John Cunningham
Partner, London
T +44 20 7532 2199
E johncunningham@whitecase.com

Alexandre Ippolito
Partner, Paris
T +33 1 55 04 15 68
E aippolito@whitecase.com

Asia-Pacific

Barrye Wall
Partner, Singapore
T +65 6347 1388
E bwall@whitecase.com

Baldwin Cheng
Partner, Hong Kong
T +852 2822 0405
E bcheng@whitecase.com

Other M&A resources

WHITE & CASE
M&A Explorer

M&A Explorer is a platform that combines an interactive tool with a regular flow of short articles from White & Case partners. The tool enables users to create charts to explore trends in M&A in every country and sector, drawing on more than a decade of data from Mergermarket.

mergers.whitecase.com

CFIUS
PILOT PROGRAM

The CFIUS Pilot Program Covered Transaction Analysis Tool enables users to conduct a quick, online analysis to determine whether a transaction could be subject to the CFIUS pilot program that implements parts of the Foreign Investment Risk Review Modernization Act (FIRRMA).

whitecase.com/cfius-firrma-tool

In this publication, White & Case means the international legal practice comprising White & Case LLP, a New York State registered limited liability partnership, White & Case LLP, a limited liability partnership incorporated under English law, and all other affiliated partnerships, companies and entities.

This publication is prepared for the general information of our clients and other interested persons. It is not, and does not attempt to be, comprehensive in nature. Due to the general nature of its content, it should not be regarded as legal advice.

Published in association with Mergermarket

An Acuris company
www.acuris.com

For more information, please contact:

Nadine Warsop
Publisher, Acuris Studios, an Acuris company

Tel: +44 20 3741 1370