Record breaker: US M&A in 2015

With confidence soaring, deal value in the United States hit new heights
Foreword

By the end of 2015, US M&A deal value reached US$1.98 trillion—surpassing the previous record set in the pre-crisis days of 2006.

As the dust settles from the explosion of US M&A activity in 2015, it is fitting to reflect on the forces that fueled the boom and consider what last year’s trends may tell us about the year ahead.

The record year resulted in part from trends that typically drive activity when M&A surges. Momentum from 2014 set the stage for M&A to reestablish itself as a primary tool for achieving strategic business and financial objectives. Many acquirers sought to jumpstart revenue growth by expanding into new markets, products and businesses. Others sought to capture scale and synergies, spurred by trends toward consolidation and convergence—particularly in sectors with significant sunk costs such as pharma, medical and biotech (PMB). Many sellers sought to shed assets to focus on core businesses, and private equity firms exploited high valuations to cash out investments.

But 2015 stands apart because a number of additional trends converged to bolster confidence and inspire risk taking among deal makers. The US economy continued its steady expansion for the sixth consecutive year while unemployment levels continued to fall. Most buyers could obtain favorable debt financing. Corporates and private equity firms amassed huge cash reserves that were available for investment—with aggregate cash piles reaching US$1.4 trillion for corporates and US$1.3 trillion for private equity firms. And for much of the year public shareholders continued to reward management teams that used cash reserves for acquisitions.

Some of these trends are continuing, but there are reasons to look forward with caution. Although overall deal value surged in 2015, the number of deals declined. The market was dominated by megadeals—and a decrease in megadeals could impact deal values in 2016. Pricing is another concern. US targets worth more than US$1 billion carried a median valuation multiple of 15.4 times EBITDA, according to Mergermarket data. This raises questions about just how much longer the bull run can continue.

It may also be getting more difficult for some companies to access cheap financing. Although debt remains relatively inexpensive, regulated banks have pulled back on issuance of leveraged loans. And shareholders may be getting more cautious, with several deals in the second half of 2015 resulting in share price deterioration for the buyers following their announcements.

Moreover, as we go to press in January, global markets are again experiencing substantial downward pressure and volatility. This could make it more difficult for buyers and sellers to agree on value, which would negatively impact M&A activity.

Although US M&A reached a record annual high in 2015, the market was skewed toward megadeals, and emerging trends may suppress activity going forward. We will need to see stability in the financial markets for M&A to continue at 2015 levels.

John Reiss
Partner, White & Case

Gregory Pryor
Partner, White & Case
US M&A market on a high

HEADLINES
- US deal values at a record annual high
- Deal values up 41 percent compared with 2014
- US M&A accounts for nearly half of total global M&A value
- Megadeals continue to bolster the market
- Consolidation, convergence, low interest rates, comparative economics and political stability are the foundations for the thriving M&A climate

The US M&A market broke new ground in 2015. By the end of the third quarter, dealmaking had already surpassed the whole of 2014, coming in at US$1.44 trillion, and by the year’s end, deals for US companies were worth US$1.98 trillion. This has taken US M&A’s total share of global value to more than 46 percent—the highest share since 2001.

In many ways, 2015 built on the comeback witnessed in 2014. The US economy continued its stable growth, with S&P forecasting GDP growth of 2.5 percent. This is the sixth consecutive year since 2009 that output has expanded, according to World Bank data, laying a firm foundation for market confidence.

Unemployment is at a seven-and-a-half-year low at 5 percent, according to the US Department of Labor. All of these signs of relative domestic strength helped to support business confidence and M&A activity.

Value vs volume
The new M&A record was ultimately driven by megadeals, some of the biggest the market has ever seen. However, activity has not been spread evenly, rather it has been concentrated in sectors such as pharmaceuticals, medical and biotechnology (PMB), and technology, media and telecommunications (TMT). Before the end of the year, Pfizer bid US$184 billion for Allergan, forming the world’s biggest drug company and marking the third-largest deal ever. Two other blockbuster transactions took place in the TMT sector—the US$778 billion acquisition of Time Warner Cable by Charter Communications and Dell’s US$83.3 billion bid for EMC Corporation.

While overall M&A value surged on the back of multibillion-dollar acquisitions, volume slowed. At the end of the year, the deal count stood at 4,819, down 8 percent from 2014 (5,237). This suggests that we are very much still in a seller’s market as cash-rich corporates are having to pay more for assets. US targets worth more than US$1 billion are selling for a median multiple of 15.4 times EBITDA, which is forcing buyers to balance the need to analyze deals against sellers’ demands for speed and certainty more deeply before they act.

The outlook for 2016 remains positive—policymakers are optimistic about the macro environment in the United States and corporate confidence is still high. And while investors should remain wary of high prices, the recent interest rate rise could potentially prompt sellers to bring assets to market sooner than expected and at reduced cost.

Moreover, there is still appetite for M&A, many companies and private equity firms are looking for opportunities to invest their significant cash reserves, and debt for financing deals remain relatively inexpensive. Thus, there is good reason for M&A to remain robust through 2016.
The five Cs of M&A

As with 2014, to a lesser or greater degree, the market is still being driven by what we are calling the five Cs of M&A: confidence, consolidation, convergence, cash supply and cheap debt.

Confidence can be seen in the continued ascendancy of the megadeal—2015 saw the Pfizer/Allergan deal among a slew of others including Royal Dutch Shell’s US$70 billion purchase of the BG Group in February. In addition, the appetite for inorganic growth appears to be as high as ever. A survey of more than 1,600 senior executives by professional services firm EY shows that 59 percent of companies are actively looking to pursue acquisitions in the next nine months—the biggest appetite for M&A in six years.

“Potential buyers have generally been interested in acting because of all the cash and the reasonably favorable financing markets and interest rate environment,” says Gregory Pryor, a partner at White & Case. “High valuations have helped get the sellers to the table and, from a corporate perspective, there’s a high level of confidence that combinations are going to result in substantial value, and I don’t see that changing right now.”

Meanwhile, we have seen growing consolidation in a number of sectors including TMT and financial services. However, nowhere was this more prevalent than in the PMB arena, where headlines were made on an almost weekly basis as the sector got smaller but the deals got bigger.

The trend toward convergence across sectors is also accelerating, particularly as companies in the TMT and entertainment sectors scale up to become ever-larger conglomerates. One such example is Google’s acquisition of Softcard in February, which would bolster the company’s Google Wallet offering as it competes with Apple Pay in the fintech (financial technology) space.

“Technology convergence is no longer seen as a ‘disrupting’ trend—but rather, it’s a competitive necessity,” says Arlene Arin Hahn, a partner at White & Case. “In order to remain nimble and viable in today’s market, it is unlikely that a company can rely solely on organic growth. The fastest, and often most reliable, way to jumpstart a company’s technology and talent is through M&A.”
And the trend is likely to continue into 2016, with convergence spreading from fintech, PMB and digital healthcare to the automotive and consumer products sectors. “The next frontier in the automotive industry is the driverless car, and the fully connected car is the first step towards that goal,” says Hahn. “Similarly, the potential diagnostic and analytic capabilities of the Internet of Things (IoT) will likely result in traditional consumer goods manufacturers investing in third-party technology solutions to revamp and update their products.”

And record cash supply will only keep momentum running high. Non-financial US companies have collectively stockpiled US$1.4 trillion, and shareholders want them to put that cash to use. This has been evidenced by pressure from activist shareholders, as was the case with diversified chemicals major DuPont. After narrowly facing down calls to streamline from hedge fund Trian Fund Management in May, the company ultimately merged with Dow Chemicals in a US$77 billion deal that will see the two companies combine their agriculture, specialty chemicals and commodity chemicals business before splitting them, fulfilling Trian’s initial demands.

Meanwhile, PE firms have US$1.3 trillion in “dry powder” ready to invest, according to research firm Preqin. Dealmaking has also been stoked by continued low interest rates, which for the most part have made for cheap debt. Low borrowing costs, driven down by the Fed’s quantitative easing program and ultra-low base rate, have provided an opportunity to deliver returns to shareholders via debt-financed M&A.

A volatile mix
Credit markets have become more volatile in recent months as investors have begun to show an aversion to risk and are thinking twice before buying debt. This is exemplified in the financing for The Carlyle Group’s takeover of Veritas. It was touted as the biggest buyout of the year, but banks were unable to sell the US$5.5 billion worth of loans and bonds. This resulted from a lack of investor interest, even after underwriters reportedly offered rates of 11.5 percent to 12.5 percent on a US$1.8 billion tranche of the debt—one of the highest yields of the year. The Veritas buyout left the software company with debt of 6.5 times EBITDA, an indication that investors are wary of more aggressively leveraged private equity deals.

China’s slowing economy and falling stock market were contagious, rattling investors’ nerves in both the equity and debt markets in the United States. And in the weeks leading up to the Federal Reserve’s recent decision to lift interest rates, it seemed that investors began to hold back, re-evaluating what they considered to be acceptable yields on corporate and leveraged debt, forcing some issuers to re-price loans and bonds, and the Wall Street banks that acted as underwriters to hold paper they intended to sell. Stock markets were not immune to this anxiety either, with the S&P 500 sinking more than 10 percent at the end of August before making a recovery. The index finished the year where it started in 2015. Uncertainty could hinder M&A going forward if the bid/ask spread between buyers and sellers widens, particularly where acquirers are using their own stock as purchasing currency.

“I feel what we’re going through right now, with turbulent trading in China and that spilling over into the US markets, might be even more volatile and longer term than what we saw in August 2015,” says John Reiss, a partner at White & Case. “That said, there is still some good economic data out there, particularly in the US.”

### Top ten US M&A deals, 2015

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Target company</th>
<th>Target dominant sector</th>
<th>Target dominant country</th>
<th>Bidder company</th>
<th>Bidder dominant country</th>
<th>Deal value USD (m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>23/11/2015</td>
<td>Allergan plc</td>
<td>Medical: Pharmaceuticals</td>
<td>Ireland (Republic)</td>
<td>Pfizer Inc.</td>
<td>USA</td>
<td>$183,739</td>
</tr>
<tr>
<td>26/05/2015</td>
<td>Time Warner Cable Inc.</td>
<td>Telecommunications: Carriers</td>
<td>USA</td>
<td>Charter Communications, Inc.</td>
<td>USA</td>
<td>$77,829</td>
</tr>
<tr>
<td>11/12/2015</td>
<td>The Dow Chemical Company</td>
<td>Chemicals and materials</td>
<td>USA</td>
<td>E. I. du Pont de Nemours and Company</td>
<td>USA</td>
<td>$76,971</td>
</tr>
<tr>
<td>12/10/2015</td>
<td>EMC Corporation</td>
<td>Computer services</td>
<td>USA</td>
<td>Dell Inc.</td>
<td>USA</td>
<td>$63,263</td>
</tr>
<tr>
<td>28/09/2015</td>
<td>Williams Companies, Inc.</td>
<td>Energy</td>
<td>USA</td>
<td>Energy Transfer Equity LP</td>
<td>USA</td>
<td>$55,888</td>
</tr>
<tr>
<td>25/03/2015</td>
<td>Kraft Foods Group, Inc.</td>
<td>Consumer: Foods</td>
<td>USA</td>
<td>Kraft Heinz Company</td>
<td>USA</td>
<td>$54,518</td>
</tr>
<tr>
<td>24/07/2015</td>
<td>Cigna Corporation</td>
<td>Insurance</td>
<td>USA</td>
<td>Anthem Inc.</td>
<td>USA</td>
<td>$54,200</td>
</tr>
<tr>
<td>26/06/2015</td>
<td>PayPal Holdings, Inc.</td>
<td>Financial Services</td>
<td>USA</td>
<td>eBay Inc. (Shareholders)</td>
<td>USA</td>
<td>$50,508</td>
</tr>
<tr>
<td>27/07/2015</td>
<td>Allergan plc (Generics business)</td>
<td>Medical: Pharmaceuticals</td>
<td>USA</td>
<td>Teva Pharmaceutical Industries Ltd</td>
<td>Israel</td>
<td>$40,500</td>
</tr>
<tr>
<td>03/07/2015</td>
<td>Humana Inc.</td>
<td>Insurance</td>
<td>USA</td>
<td>Aetna Inc.</td>
<td>USA</td>
<td>$36,633</td>
</tr>
</tbody>
</table>
Companies tend to see their equity as undervalued by the market, and any recent falls in share price will magnify this view, creating a gap between what shareholders think their business is worth and how much buyers are willing to pay. But so far, US M&A markets have shown resilience to foreign macro shocks and even the resultant volatility in domestic equities.

**US safe haven for Asia**
One of the major stories of 2015 was the prevalence of Asian players that have been showing a significant interest in US assets. Japan was the third most acquisitive country by volume after Canada and the United Kingdom, accounting for 69 deals this year, putting it just ahead of China.

"With China’s growth slowing and the heavy stock market volatility, Asian powerhouses feel that the US remains a safe haven," says Reiss. "During the crisis, everybody was looking at emerging markets, but now the US is looking like a good place to put money, as the underlying economy looks pretty stable."

Japan has been flirting with recession even as Japanese companies sit on some US$2 trillion in reserves, nearly half the size of the nation’s economy. With poor prospects at home, Japanese companies have been looking to the United States for growth, particularly where brands have a strong foothold in the country. This was demonstrated by Japan Tobacco buying US$5 billion worth of assets from rival Reynolds American, including the Natural American Spirit brand.

There have also been strategic motives. Insurers have been some of the most active buyers, as they diversify their geographical exposure to natural disasters. Tokyo Marine, the biggest name in Japan’s insurance sector, agreed to buy US firm HCC Insurance Holdings for US$7.5 billion, the biggest inbound deal from the country in 2015.

With China devaluing the yuan against the dollar in a bid to jumpstart its economy and US GDP holding up well, Chinese companies also looked to the United States as a relatively safe haven. This revealed itself in inbound M&A figures, which surpassed 2014 in both value and volume terms at US$18.08 billion invested across 60 transactions.

Total value was bolstered by the US$3.3 billion sale of LED maker and patent owner Lumileds to Go Scales, a consortium comprising GSR Capital, Nanchang Industrial Group and Asia Pacific Resources Development. China is attracted to the United States because it can buy companies and introduce them to its higher-growth market. In addition, the country is at pains to wean itself off coal and transition to cleaner fuel sources. This has meant manufacturers of energy-efficient technologies such as the LEDs made by Lumileds have become prime attractions.

In addition, US oil assets have become attractive to Chinese buyers in the face of competition from China’s state-owned operators. In October, investment firm Yantai Xinchao agreed to pay US$1.3 billion for oil assets in the western Texas Permian Basin from Tall City Exploration and Plymouth Petroleum.

Interest from Asian buyers may soften in 2016. Owing to its economic robustness and in anticipation of an imminent rate rise, the US dollar has appreciated as Japan’s yen weakened and China’s central bank unpegged the yuan.
Top 10 inbound bidders by value

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John Reiss, Global Head of M&A, White & Case
Top 10 outbound targets by volume

Top 10 outbound targets by value
Antitrust: Eyes on the prize

As M&A hits new record levels, antitrust regulators across the globe are scrutinizing more deals—and not just the blockbusters

The prevalence of multibillion-dollar deals between market leaders has inevitably put the issue of antitrust high on the corporate agenda in 2015. When two big players look to merge, there is a greater likelihood that antitrust issues will arise. Indeed, a number of high-profile deals have fallen foul of regulators this year, including the proposed deal between appliance makers GE and Electrolux.

However, White & Case partner Rebecca Farrington says that regulators are keeping their eyes wide open and not just focusing their attention on the giant deals that have been making the headlines.

“Antitrust agencies around the world have been very active in investigating deals of all sizes, so it’s not just the megadeals. Smaller, local transactions can have just as much—or more—effect on consumers. In addition, some sectors such as healthcare and pharmaceuticals continue to see heightened scrutiny,” she says. “And it is not only the transactions that have to be affirmatively reported to the Federal Trade Commission and Department of Justice before closing—there have been an increasing number of investigations into deals that fall below the reporting thresholds.”

Antitrust abroad
Any corporate pursuing a deal should have an antitrust strategy in place before they make a bid. This becomes even more crucial when exploring cross-border targets. A clear indication of this comes from China. In October, the country’s Ministry of Commerce stated that the number of antitrust investigations had risen by 43.5 percent in the first nine months of 2015.

It is vital not only to understand the competitive dynamics in foreign markets but also the nature of how those markets are regulated.

“Every jurisdiction has its own reporting thresholds and rules,” says Farrington. “Companies should be very smart about how they approach a transaction by looking at where they have to file and thoroughly analyzing markets to see where there are serious competitive concerns or where there are longer waiting periods. All of those considerations should be built into the closing timetable.”

This preparation is not simply a matter of abiding by rules—there are financial implications to consider. Companies need to carefully analyze all of their business lines and assets for any potential competitive concerns and be prepared to sell where necessary.

“Antitrust should always be part of M&A due diligence to understand how big the competitive risks could be. If the concerns are high enough in particular overlapping business areas, then the divestiture possibilities should be considered from the start,” says Farrington. “You need to be aware of the potential financial impact, as it can affect the overall economics of the deal. Divestiture assets are often sold at ‘fire sale’ prices; it’s always pennies on the dollar.”

from the dollar to prop up growth. This foreign exchange pressure will make US companies relatively less attractive in 2016 and could slow activity.

However, White & Case partner Reiss feels there are more deals to come from Asia. “I don’t see that the situation in China and Asia is going to make Asian investors less interested in the US. In fact, it seems quite the opposite.”

US outbound
The value statistics for US outbound dealmaking reflect a changing M&A landscape. The steep fall of investment into Ireland in the first nine months of the year may be due in part to measures taken by the US Treasury to close loopholes related to tax inversion deals, which involved US firms buying companies in the low-tax jurisdiction in order to re-domicile to lock in lower tax rates.

However, a single deal—Pfizer’s US$184 billion acquisition of Dublin’s Allergan—made Ireland a significant destination once again in value terms, even if volume has remained low. The reverse takeover, which reflects Allergan’s tax domicile in Ireland, shows how US companies will look to other countries opportunistically.

In terms of emerging markets, India has seen an increase in both the overall value and volume of deals coming from the United States. This comes at a time when the country has replaced China as the fastest-growing major economy in the world, with GDP expansion of about seven percent, and as the government makes efforts to streamline the country’s complex tax system and reform labor rules to promote business. These positive signs appear to be attracting US capital. In the first nine months of 2015, investment into India had already surpassed 2014. One of the year’s most notable deals saw American Tower Corporation buy a 51 percent stake in Viom Networks for US$1.9 billion.
Three sectors dominated the US M&A charts this year. The pharmaceutical, medical and biotechnology (PMB) sector was way ahead of the field in terms of deal value, where a series of megadeals took its value haul to record levels.

The PMB sector accounted for almost US$300 billion worth of deals in 2015. This was followed by the energy, mining and utilities (EMU) sector, which saw an aggregate of US$274.78 billion worth of transactions over the same period. In both, there was a gap between value and volume, as megadeals led activity.

Transactions such as Pfizer’s US$184 billion move for Allergan have distorted the figures to a degree. Indeed, there were only 536 deals in the PMB sector in the year, just creeping over 2014’s 520 deals.

In volume terms, technology and industrials were well ahead of other industries. In the case of technology, and unlike PMB, activity was not so heavily weighted toward a few mammoth deals. Certainly, there were heavy-hitters such as the US$77.8 billion acquisition of Time Warner Cable by Charter Communications and Dell’s US$63.3 billion bid for EMC Corporation. But with 781 transactions recorded in 2015, technology was less skewed toward the upper end of the market compared with other industries. For more on M&A in the technology sector, see “A new wired world,” on page 13.

Life sciences strategy
In 2014, M&A in the PMB sector was spurred by US companies buying foreign competitors to drive down tax bills by relocating their headquarters to countries with lower corporate rates. The US
CFIUS: Near the mark

A US business’s close proximity to sensitive US government sites can cause major issues for a deal. So just how close is too close?

Before bidding in the United States, foreign investors must give careful thought to whether any proposed deal is likely to draw the attention of the Committee on Foreign Investment in the United States (CFIUS). One major concern is a US business’s close proximity to facilities or areas considered sensitive by the US government.

The most high-profile case that highlights close proximity issues related to CFIUS began with the March 2012 acquisition by the Chinese-owned Ralls Corporation of four Oregon wind farm projects. After the transaction closed, the Committee flagged the deal because it thought the assets were located too close to a US Navy training range, and the President ultimately ordered that the wind farms be sold within 90 days. Following three years of litigation, the matter has finally been settled, but not without significant cost.

“Given the stakes, it is essential that overseas acquirers understand how CFIUS factors proximity into its determination of whether a deal threatens US national security,” says White & Case partner Farhad Jalinous.

Any deal in which the target business owns physical assets near military bases or training grounds may raise concerns. However, there is no strict rule on what constitutes close proximity, and not all military assets are equally sensitive. It may pay to look at airspace restrictions in a location, but this will only give an indication of the likelihood that proximity is an issue. In the case of Ralls, its wind farms were not near or adjacent to the naval air base that was at the center of the proximity concerns.

“Another point to consider is the immediate area surrounding the target assets,” says Jalinous. Urban areas could warrant less attention from CFIUS since the proximity of any military training grounds or other US government activities to densely populated areas will have already been considered.

It is not just proximity to buildings that raises red flags. Concerns are often raised where the target business is involved in digging underground or under water, or operates towers or elevated structures, which was one of the issues with the wind turbines owned by Ralls Corporation. While it has not been explicitly stated, the inference is that such access could open up the potential for surveillance. This is liable to impact deals in sectors such as mining, upstream oil and gas, and energy.

It’s important for companies and investors to conduct in-depth due diligence to ascertain whether there are likely to be any proximity-related obstacles to getting CFIUS approval for a deal. Even if there are, mitigation measures tend to focus on specific assets of concern rather than whole businesses. This means that such deals might still be viable, so long as a particular facility is divested or retained by the vendor.

Until now, all deals that have been publicly blocked due to proximity issues involved Chinese investors. However, one could deduce that any buyer from a country that is considered to be a military adversary to the United States or even an ally to an adversary is at risk of having deals rejected.

In principle, Chinese investors are very welcome in the United States. Numerous Chinese acquisitions of US businesses succeed each year. Moreover, during President Xi Jinping’s state visit in September, both the United States and China committed to limiting the scope of reviews of foreign direct investment to national security alone, ruling out economic or public interest issues for reasons to scrutinize and block deals. America’s door is open. But investors must be mindful of how to work the locks.

Mort Pierce, Partner, White & Case

The majors are always looking for the next blockbuster drug. We’ve seen deals where a company has developed a product that has the potential to be huge. Apart from the megadeals, there’s a lot of activity in companies that are developing drugs that have the potential to be blockbusters.

“
A new wired world

Technology is one of the major driving forces behind the M&A revival—both for those within the sector and outside it.

The M&A revival has been driven by a number of factors such as cash supply, cheap debt and consolidation. However, the role of technology has perhaps been underplayed, not just as a sector in itself but also as a facilitator of deals across all sectors.

In the deal market, tech companies have been looking outside native sub-sectors to provide more integrated solutions to their customers. Meanwhile, older generation technology companies are making acquisitions to stay relevant (for example, hard drive manufacturer Western Digital’s US$19 billion acquisition of flash drive company SanDisk in October).

Meanwhile, non-tech companies need the solutions offered by those in the digital sphere, whether in mobile, online payment, IoT, security or big data, to bring their business offerings in line with the digital age and meet changing customer demands and behaviors.

This has meant that valuations have sky-rocketed. “The best technology-enabled companies offer their buyers a gateway into the future, in terms of product offerings, customer solutions, company culture and vision,” says White & Case partner William Choe. “And a premium is being placed on this gateway. This coupled with ready cash, inexpensive financing and a need to ‘stay relevant or fade away’ are the factors that have been driving up technology company valuations.”

And in the coming year, M&A in the sector could grow even further. There is no shortage of startups taking their crack at “disrupting” old-line industries—taxi services (Uber, Lyft), lodgings (Airbnb), pet lodgings (DogVacay) and even the neighborhood laundry service (Washio) have become significant online properties. Whether or not the disruptive companies get acquired by their old-line counterparts, acquire them or replace them outright remains to be seen.
The US M&A market in figures

Total US M&A 2010—2015

![Graph showing volume and value of US M&A from 2010 to 2015.]

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


**Inbound M&A by country, 2015**

<table>
<thead>
<tr>
<th>Country</th>
<th>Deals</th>
<th>Value (billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Switzerland</td>
<td>26</td>
<td>US$30.9 billion</td>
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<tr>
<td>Canada</td>
<td>182</td>
<td>US$3.3 billion</td>
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<tr>
<td>Ireland</td>
<td>42</td>
<td>US$29.7 billion</td>
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<td>Germany</td>
<td>48</td>
<td>US$7.1 billion</td>
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<tr>
<td>France</td>
<td>52</td>
<td>US$3.7 billion</td>
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<tr>
<td>Japan</td>
<td>69</td>
<td>US$33.7 billion</td>
</tr>
<tr>
<td>China</td>
<td>60</td>
<td>US$18.0 billion</td>
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**Outbound M&A by country, 2015**

<table>
<thead>
<tr>
<th>Country</th>
<th>Deals</th>
<th>Value (billion)</th>
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<tbody>
<tr>
<td>UK</td>
<td>247</td>
<td>US$61.8 billion</td>
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<td>Canada</td>
<td>184</td>
<td>US$14.2 billion</td>
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<td>Brazil</td>
<td>56</td>
<td>US$5.2 billion</td>
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<td>Australia</td>
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<td>France</td>
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<td>Germany</td>
<td>94</td>
<td>US$18.3 billion</td>
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<tr>
<td>India</td>
<td>82</td>
<td>US$3.6 billion</td>
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</table>

* Indicates by size, where the smallest is US$128 billion, and the largest is US$621 billion.

* The Intelligence Forecaster is based on ‘companies for sale’ tracked by Mergermarket in the United States between July 1 2015—31 December 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.
The buoyancy in the buyout sector towards the end of the year reflected the broader M&A market. After a slow start to the year, the value of deals surged in the second half despite a dip in transaction volume. Some US$122.68 billion worth of deals were sealed in H2, up almost US$40 billion on the second half of 2014, yet down 15 percent on a volume basis over the same period.

This rise in value coupled with a fall in volume was a hallmark of M&A in 2015, and the private equity sector has been no exception. Funds have plenty of money—US$1.3 trillion on a global basis, according to research firm Preqin—that they are looking to invest; and this has made conditions perfect for sellers in recent years, but more challenging for buyers.

“Private equity firms have a lot of funds to deploy. Vendors and strategics know this, and bankers are marketing bigger deals because they know that these firms have the appetite and assets to do deals,” says White & Case partner Oliver Brahmst.

Indeed, the competitive tension caused by the abundance of capital appears to be creating a disconnect between overall deal value and volume.

Join the club
With asset prices running high, PE has been reviving one of its former strategies—clubbing together with like-minded co-investors. “Club deals allow PE firms to invest together to pay higher multiples and provide equity backstops that sellers are demanding,” says White & Case partner Carolyn Vardi.

The largest deal of the third quarter saw The Carlyle Group and Singaporean sovereign wealth fund GIC take over Veritas Technologies for US$8 billion. Likewise, Solera Holdings was picked up by Goldman Sachs, Koch Industries and Vista Equity Partners for US$6.5 billion. Both companies sell software, a favorite sector among PE firms, and these deals helped to drive overall technology buyouts to US$41 billion.
in 2015, making it the top sector by value.

“PE firms are not looking at start-ups like Airbnb or Uber, but they like software companies and, they are trading at very high multiples right now,” says Brahmst. “Software companies have low capex, so PE firms don’t have to put in a lot of capital over time. And once they have proven technology, it’s possible to scale them up.”

The most noteworthy club deal of the year, however, featured a familiar name. Electricity transmission business Oncor was acquired for US$12.2 billion by a consortium comprising industry operator Hunt Consolidated as well as financial sponsors Anchorage Capital Group, Arrowgrass Capital Partners, BlackRock, Centerbridge Partners, the Blackstone Group’s GSO Capital Partners, Avenue Capital Group and the Teacher Retirement System of Texas.

Oncor was formerly part of Energy Future Holdings, which in 2007 became the subject of the biggest PE buyout on record when KKR and TPG Capital paid US$48 billion to own the energy business. It was also the industry’s largest write-off after the company
Sellers rule the market

The current seller’s market—fueled by corporate and PE’s capital reserves and the revitalized confidence from deal-hungry corporates—and the curtailment of leveraged loans are the biggest obstacles facing private equity. “Funds are having to think long and hard about their strategies for an asset in order to rationalize accepting high multiples,” says Vardi.

Gone are the days when firms could rely on financial engineering for their returns, and regulators have had a hand in the shifting dynamics. The Fed’s guidance on leveraged loans, specifically warning Wall Street banks against lending that pushes companies’ debt above six times EBITDA, has influenced where the industry looks for debt financing.

For more on leveraged loans, see “Has leverage reached its limits?”, on page 20.

Vista Equity Partners financed its buyout of software business Sovos Compliance with a loan from alternative lender Golub Capital. Vista was prepared to accept a higher rate in exchange for a leverage multiple of seven times EBITDA. With traditional lenders hamstrung by the Fed, private equity firms are prioritizing debt quantums above repayment costs.

Given the restraint from banks on leverage, and with seemingly little headroom for further multiple inflation, there is more pressure than ever on private equity firms to optimize operations to capture returns. This means putting more store in due diligence to identify cost savings and ways to consolidate markets through add-on acquisitions.

Limited partners (LPs) are looking very hard at returns, and they are scrutinizing funds’ investment decisions,” says Brahmst. “Funds that overpay and can’t make the returns won’t be in business for long.”

Conversely, conditions have scarcely been better for vendors, who are taking advantage of pricing while it’s high. PE firms made US$200 billion worth of exits compared with US$190 billion worth of investments. As was the case in 2014, company sales are outstripping new investments, as sponsors avoid bidding wars with corporates and continue to exercise discipline.

Investors are keeping an eye on rate rises, but these are likely to continue to be incremental and, with continued positive signs in the economy, this is unlikely to put a dampener on the market. “Short of a recession, I don’t see what can hurt the industry right now,” says Brahmst. “Activity will continue, and the interest rate rise won’t change anything materially. It will help buyers rather than sellers, and that might not be such a bad thing.”

IPOs: Slow floats

Private equity IPOs in public markets have slowed substantially this year, but they remain an important exit route

Private equity-backed IPOs dropped significantly in 2015, as might be expected from what was a down year in general for public offerings. Figures from professional services firm EY show that in the first nine months of the year, private equity firms raised US$38.5 billion in total proceeds from IPOs, a 60 percent fall compared to the same period in 2014. The 120 IPOs of PE-backed companies represented a 26 percent drop by volume.

Following market shocks in August, investors showed signs of caution that affected the sponsor-backed Albertsons IPO, one of the biggest IPOs of the year, both of which were backed by sponsors. In October, Cerberus pulled the sale of grocery store chain Albertsons after bookbuilders could only convince investors to pay US$20 a share instead of the indicative US$23 to US$26 range.

“Many investors are wary of highly leveraged companies, especially where profit growth is lacking,” says White & Case partner Colin Diamond. “For example, Albertsons is carrying debts of US$12 billion from its buyout.”

In the tech space, there is evidence of frothy valuations correcting themselves in the public arena. IPOs by Square, the mobile payment service, and Box, the online file-sharing company, resulted in valuations for these companies that were below those achieved in previous venture capital financing rounds. “Some analysts think that IPOs for many tech startups will effectively be ‘down rounds,’ resulting in valuations that are lower than they were in previous stages of funding,” Diamond says. “Nevertheless, it’s important to take a longer-term view and not put too much emphasis on how companies are priced on day one following an IPO.”

IPOs will continue to be an important exit route for private equity. In the United States, between 22 percent and 32 percent of all IPOs in the last five years were of PE-backed companies. However, firms will need to be confident about the medium-term health of the public markets before listing companies, something that was absent last year; in 2015, the S&P 500 returned -0.73 percent.

Unlike the process for doing secondary or trade sales, the IPO process is time-consuming and involved, requiring companies to spend many months of preparation culminating in two weeks of roadshow meetings with investors. In addition, funds are subjected to 180-day lock-ups before they can sell further stock. This lack of a complete exit can be a turn-off for PE funds. However, there is also the opportunity to benefit from further upside if the company appreciates in the aftermarket.

According to Bain & Company, the holding period before PE exits increased to 5.7 years in 2014 from 3.4 years in 2008, as funds concentrated on getting their companies through the crisis and waited to sell in rising markets. Some potential M&A deals, like Albertsons, are too big to garner interest from other PE firms and don’t offer enough strategic potential for corporates, leaving the IPO as the most credible exit option.
Has leverage reached its limits?

Leveraged lending guidelines have contributed to the relative decline in private equity M&A in the United States

In a record year for US M&A, one traditional source of deal financing, leveraged lending for private equity firms, is under pressure. In 2015, leveraged loans by banks—traditionally, a key source of funding for private equity firms undertaking deals—were down 32 percent from a year earlier, according to Debtwire. By contrast, between 2009 and 2013, US leveraged loan volumes surged nearly threefold, reflecting vibrant post-crisis activity by private equity firms.

“In 2015, competition from cash-rich corporates, high valuations and pressure on leveraged lending from US regulatory authorities combined to drive PE firms’ share of US M&A volume to its lowest level since 2009,” says Eric Leicht, partner at White & Case. According to Mergermarket data, PE buyouts as a percentage of US M&A was at 18.2 percent in 2015, the lowest level since falling to 16.6 percent in 2009.

The question is whether—or to what degree—the relative decline in private equity’s role in M&A is due to limits placed on banks via the leveraged lending guidelines that were issued in 2013.

Although many factors were at play, we believe that the guidelines prevented many PE firms from obtaining loans at the leverage levels needed to compete for some of the larger deals in 2015, particularly given soaring valuations. As banks complied with the guidelines, PE firms were taken out of the running.

**Banks on the retreat**

In 2013, the US Federal Reserve, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) published updated guidance to financial institutions involved in leveraged lending. In their guidance, the agencies flagged their concerns that some banks’ lending policies were becoming too risky. While noting that leveraged lending had declined during the crisis, they commented that “volumes have since increased, and prudent underwriting practices have deteriorated.”

The guidance took some time to bite, but by 2014 a number of banks had received letters from regulators demanding “immediate attention” to their leveraged loan portfolios, causing some proposed deals to be put on ice. In November 2014, the agencies provided clarification of the criteria to be used when assessing compliance with the guidelines in the form of an “FAQ” addressed to market participants.

In November 2015, the Federal Reserve noted that, while banks had made progress in meeting the 2013 guidance, it still observed gaps between industry practices and those that regulators consider safe and sound.

In particular, the central bank pointed out a sharp rise in substandard, doubtful or loss-making loans to the oil & gas sector, from 3.6 percent of total classified commitments in 2014 to 15 percent in 2015. The Federal Reserve’s recent comments offer little comfort for anyone hoping for a softening in regulators’ approach.

**Non-banks lend a helping hand**

However, not all lenders are constrained by the rules. Three categories of institution typically provide leveraged finance to support US M&A activity:

- **Regulated banks**
- **Non-regulated financial institutions (non-banks, such as securities companies, that offer leveraged loans)**
- **Alternative capital providers (hedge funds, asset managers and private equity funds)**

Of these three types of lender, only the first—regulated banks—is covered by the guidelines. Due to the guidelines, these banks have sometimes been unable or unwilling to participate in financing deals where debt exceeds six times EBITDA. This puts practical limitations on financing acquisitions as deal sizes grow, because big banks are important for the execution of large deals—primarily because of their larger balance sheets and sophisticated distribution platforms.

Unsurprisingly, non-regulated institutions and alternative capital providers are now taking up some of the slack in the leveraged lending market. Recent statistics indicate that many non-regulated financial institutions, such as Jefferies LLC, Nomura and Macquarie Group, grew their US loan businesses significantly since 2013. Figures from Thomson Reuters show that players in this category took a 22 percent share of lending to support US leveraged buyouts in the first three quarters of 2015, double the levels of a year earlier.

The availability of financing from alternative capital providers is likely
to depend on the size of the deal. “If you want to raise more than a billion dollars of debt, you will likely still have to include at least one of the big money center banks that has the distribution power to syndicate a deal,” says Jake Mincemoyer, partner at White & Case.

At the lower end of the size scale, the motivations and capacity of a leveraged lender may be quite different. “If you need only a couple of hundred million dollars of debt to finance a deal, a private investment fund that buys and holds debt may step in because they have the resources to handle that level of commitment,” adds Mincemoyer.

Across the market, non-regulated institutions and alternative financers now seem to have a substantial new opportunity. For example, in November, Golub Capital joined Barclays, Morgan Stanley and Macquarie in arranging a US$1.6 billion facility for the US$2.7 billion buyout of healthcare analytics provider MedAssets. It was the largest deal the alternative lender has been involved with to date. Unlike underwriting Wall Street banks, Golub and its competitors have a large appetite for holding loans as well as syndicating them with investors. “Some of the alternative capital providers now have big aspirations to build out their distribution side,” comments White & Case’s Leicht. “They want to be able to market a credit and then combine a possible buy-and-hold strategy with the ability to syndicate deals, along the lines of the traditional investment banking model.”

Record valuations
High prices have been an important factor for buyout firms reviewing their deal financing options. Valuations reached near record levels in 2015, rising to an average of 16.5 times EBITDA in the United States during the first half of the year, according to Intralink’s Deal Flow Predictor. By comparison, in deals involving private equity firms as buyers, valuations have averaged 10 times EBITDA, according to Standard & Poor’s. It would seem that stockpiles of corporate cash and high valuations of stock used as currency for many of these trades have managed to push private equity to the sidelines when it comes to the bigger deals. “It’s not just the guidelines that have been affecting private equity firms’ overall levels of M&A,” says Mincemoyer. “When a firm looks at a potential acquisition, it needs to find not just a strategic fit from a business perspective, but also an acceptable internal rate of return (IRR). Valuations in some sectors are getting tougher from the point of view of IRR expectations.”

However, irrespective of high valuations and the recent decline in M&A market share, the leveraged finance market is likely to continue to evolve. While banks still have a dominant role in larger deals, the competitive advantage for non-banks with the infrastructure to syndicate and distribute loans is increasing, particularly in medium-sized deals. And there will be a more prominent role for alternative capital providers in financing smaller leveraged loans.
Conclusion
There is plenty to be positive about in the US M&A market. Deal values have reached an all-time high, and appetite for deals is strong. The economy is buoyant, balance sheets are robust and both companies and private equity firms have cash to put to work, which should sustain activity in 2016.

There are reasons to exercise caution, however. Pricing has reached heights not seen since the last credit boom, and megadeals concentrated in a small number of industries are dominating the market. In volume terms, activity was down year-on-year. Not only that, volatility in capital markets is having a knock-on effect on M&A.

With 2015 behind us, dealmakers should be aware of the potential risks and trends that lie ahead:

It will pay to be prudent: The market has scarcely been more competitive, and purchase multiples continued to rise throughout the year. This may cool off in 2016, as the effect of the interest rate rise comes to bear and debt financing becomes marginally more expensive. Ultimately, buyers will have to ensure that their investment theses are rock-solid and would do well to avoid highly contested auctions where possible.

Beware of debt tremors: Investors are becoming more risk-averse in the face of overheating credit markets and the interest rate being lifted. So far, it has only been the lowest-rated debt that companies are finding more difficult to sell. This will likely punish private equity firms looking to the junk bond market to finance deals with highly leveraged structures. Debt is likely to be harder to access and will come at a higher price than it has in the last two years.

Activists are more vocal and more influential: As demonstrated by the likes of diversified industrials DuPont and Dow and Internet giants Yahoo, the activist investors continue to be a significant influence on the M&A market. According to ratings firm Moody’s, incidents of shareholder activism in the United States have risen year-on-year since 2009. Awareness is not enough; dealmakers need to engage with shareholders before “things get ugly”.

Use tech to seal the deal: Technology has made it easier to collect, digest, analyze and share information. By expediting and simplifying these processes, technology allows parties to focus on the deal itself, rather than the mechanics of getting it done. Technology facilitates the sourcing of transactions by identifying potential buyers and sellers through online sourcing networks. It also enables the simultaneous dissemination of information to multiple parties across multiple jurisdictions through virtual data rooms and other cloud-based platforms, thus allowing auctions to be opened up to larger pools of potential bidders. Ambitious buyers need to come to grips with the disruption in dealmaking or they risk getting left far behind.
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