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Key Drivers of Global Mergers & Acquisitions since the Financial Crisis

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Key drivers of global mergers & acquisitions since the financial crisis

By Alexander Georgieff and Frank Bretag** / ****

Content

I. Introduction

The financial crisis, which was triggered by the bankruptcy of the investment bank Lehman in 2008, caused global equity indices to fall sharply, and mergers and acquisitions ("M&A") deal activity to slow down. It was followed by the European sovereign debt crisis and the near bankruptcy of Greece, a European Union and eurozone member country, which threatened the stability of the common currency. Governments and central banks around the world cooperated successfully to avoid a financial meltdown, financial markets recovered but global M&A remained subdued. It only picked up again in 2014, and stayed strong until recently.

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Coordinated monetary policy measures fuelled a remarkable global economic recovery and, as a result, one of the longest-ever bull markets for global equities in modern financial history. However, recent market turbulence has interrupted this trend and has also led to a decline of global M&A, possibly ending a cycle.[1]

This paper reviews M&A activity since the beginning of the financial crisis until the end of 2018. It seeks to identify its key themes and drivers, and discusses their relevance for future M&A activity.

II. Economic and financial market background

During the last quarter of 2018, global equities declined rapidly and market volatility rose sharply. The S&P 500 Index lost at one time more than 20 percent from its previous peak, which is indicative of a bear market.[2]

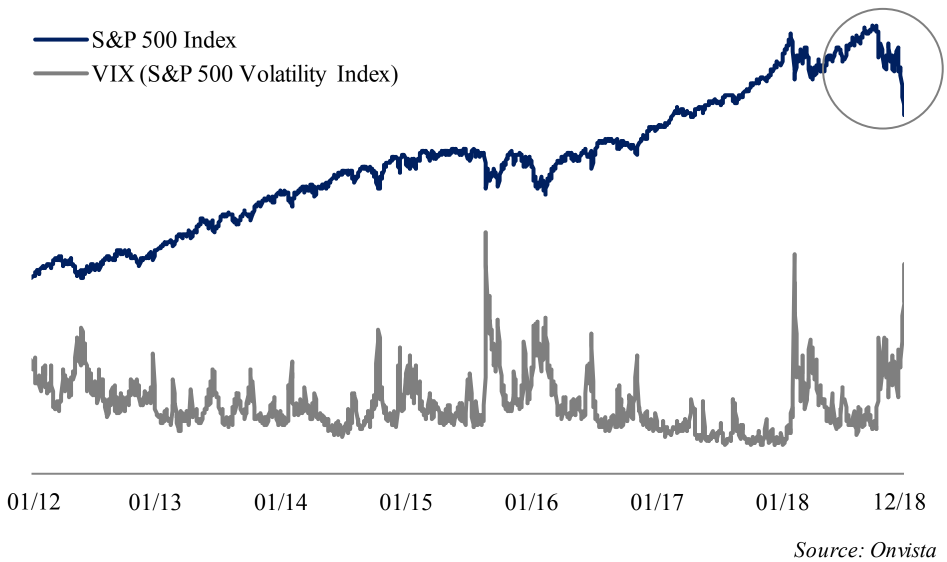

Figure 1: Development of S&P 500 Index and S&P 500 Volatility Index (VIX)

[1] Monetary policy measures included the reduction of interest rates to zero or below that, the provision of effectively unlimited liquidity through central bank refinancing operations and purchases of financial assets, including sovereign bonds ("quantitative easing"). These measures succeeded in stabilising the financial system, but triggered strong price increases across asset classes as investors redirected funds from low-risk investments yielding no or low financial returns towards higher-yielding investments in riskier assets. Due to the sustained global economic recovery (since the financial crisis) and the expected rise of inflation, central banks have ended (Fed) or reduced (ECB) quantitative easing and are moving towards interest rate increases, causing concern amongst investors about the effects this will have on economic growth and financial markets. (For a discussion of the risks of excessive and/or prolonged monetary stimulus measures, please refer to the speech of Dr. Jens Weidmann, President of the Deutsche Bundesbank, delivered on 14 September 2017 at the Institute for Monetary and Financial Stability, Frankfurt am Main).

[2] A bear market is a condition in which securities prices fall 20 percent or more from recent highs amid widespread pessimism and negative investor sentiment (…). The US major market indexes fell into bear market territory on December 24th, 2018 (…). (see www.investopedia.com).

Investors' base case scenario of a moderately growing global economy in a continuing low interest rate environment gave way to increasing concerns about slower growth, rising interest rates, protectionist barriers to international trade and political instability.[3]

Although an equity market correction was much anticipated in light of (well flagged) tightening monetary policies,[4] declining corporate organic growth and peaking earnings margins,[5] its suddenness and severity were remarkable.[6] Neither had economic and corporate data delivered any evidence of an imminent global recession; nor had a single "shock" occurred similar to the implosion of Lehman (2008) or the Greek sovereign debt crisis (2010-2012).

Yet, global economic uncertainty had reached a very high level. Global investors were (and still are) worried, in particular, about the effects of worsening political and economic relations between the United States ("US") and China, the consequences of the United Kingdom's likely exit from the European Union ("EU") and the potential eruption of a sovereign debt crisis in Italy.[7]

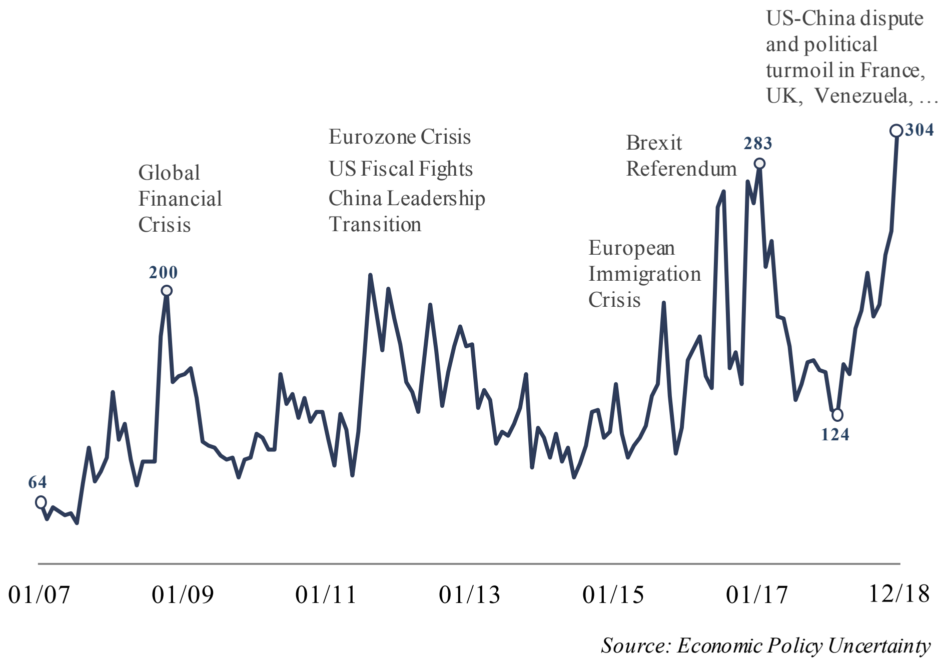

Figure 2: Global Economic Policy Uncertainty Index

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[3] International Monetary Fund, *World Economic Outlook*, October 2018; World Bank, *Global Economic Prospects*, January 2019.

[4] Financial Times, *"Fed official says: US ready for return to tide monetary policy"*, 3 October 2018; Bloomberg, *"Ultraloose ECB Monetary Policy Signals Faster Tightening Ahead"*, 12 August 2018.

[5] FactSet Research Systems Inc., *Earnings Insight – Key Metrics*, 11 January 2019; CNBC, *Companies are warning about declining profits, which could mean trouble for this bull market*, 26 September 2018.

[6] While the market dip can be explained with reference to deteriorating economic circumstances and investors' fundamental market concerns, it was aggravated by technical factors, such as the impact of balancing trades by investors employing risk parity and passive index tracking strategies.

[7] World Bank, *supra* note 3, pages 30-34; Eurasia Group, *Top political risks 2019*, www.eurasiagroup.net.

Recent market turbulence, which may have signalled the end of the last prolonged bull market in global equities, has already negatively affected activity in the global M&A market, as will be discussed below.

III. The M&A market in 2018

Possibly the last year of a long and robust M&A cycle, deal activity started strongly in 2018, but declined during the second half. The combined value of all globally announced deals amounted to $4 trillion, the fifth consecutive year that global deal volume surpassed $3 trillion.[8]

Global M&A activity was driven by mega deals in 2018.[9] Companies around the world pursued strategic combinations to boost revenue growth and better compete against "a new tide of digital disrupters across all industries"[10]. They took advantage of strong debt and equity markets up until the end of the third quarter, by borrowing cheaply and using their highly rated shares as acquisition currency. Transactions worth more than $5 billion rose strongly to a total of about $1.5 trillion (vs $1.0 trillion in 2017), representing about 38 percent of overall volumes in 2018 (30 percent in 2017).[11] Deals with a price tag higher than $10 billion rose from 32 transactions in 2017 to more than 44 in 2018.[12] Many of these deals were launched with urgency, in anticipation of a market window of opportunity potentially closing soon.

Cross-border M&A activity in 2018 amounted to $1.6 trillion, a 32 percent increase compared to 2017, in what was the strongest year for cross-border M&A since 2007.[13] This was the case despite the continuing slowdown of China outbound M&A, which has been suffering from more restrictive trade and national security policies in many developed markets.[14]

Global buyside private equity transaction value reached a record high of around $812 billion in 2018, which represented 20 percent of total deal activity by value.[15] Leveraged buyout ("LBO")

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[8] See figure 4 and JP Morgan Chase & Co., *2019 Global M&A Outlook*, page 2; Bain & Co., *M&A in Disruption: 2018 in Review*, page 6, figure 1.1.

[9] JP Morgan Chase & Co., *supra* note 8, page 2.

[10] Financial Times, *"M&A activity dives in fourth quarter as corporate confidence ebbs"*, 26 December 2018.

[11] Thomson Reuters, *Mergers and acquisitions review – Full year 2018*, page 1.

[12] JP Morgan Chase & Co., *supra* note 8, page 2.

[13] Thomson Reuters, *supra* note 11, page 1; Thomson Reuters, *Mergers and acquisitions review – Full year 2016*, page 1.

[14] Infra chapter IV 2 b).

[15] Thomson Reuters, *supra* note 11, page 1.

activity soared to its highest level since the financial crisis.[16] Significantly, large LBOs (> $1 billion) happened more frequently in 2018.[17] Even some $10 billion-plus private equity backed acquisitions were announced during the year.[18] This is all the more remarkable when one takes into account that the pace of private equity spending slowed to a 10-year low. Private equity firms went from using more than five percent of their capital, quarter on quarter, at the height of the boom years in 2006, to utilising only about one percent in the last three months of 2017.[19] Whether this shows that private equity managers were cautious to underwrite transactions at the perceived valuation peak of the market or is merely an indication of an over-allocation of investor funds to the private equity asset class remains to be seen. However, it is a fact that buyout firms were under great pressure to deploy capital.

LBO valuations rose yet again from an already high base.[20] This can be attributed to ever-increasing competition from both strategic and financial buyers and the continuing availability of cheap debt finance, on "lite" terms (although the latter has shown first signs of tightening).[21]

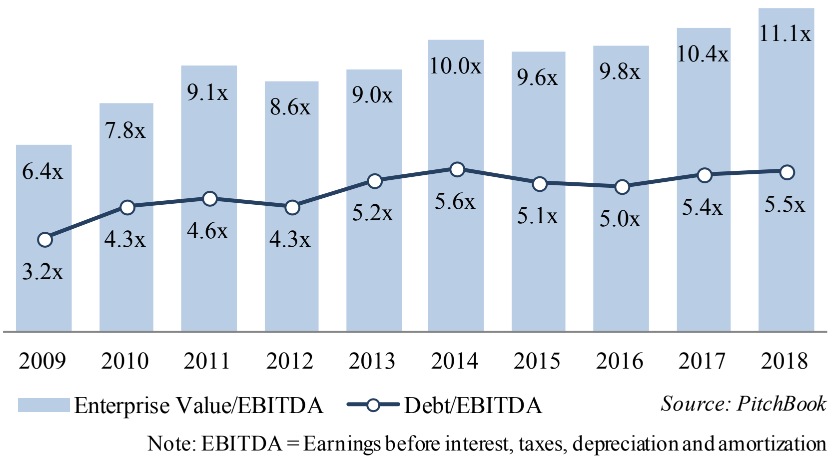

Figure 3: Global median private equity M&A multiples

M&A related shareholder activism continued strongly in 2018, when M&A demands featured in 216 activist campaigns (183 in 2017).[22] In 67 percent of these campaigns activists advocated for an

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[16] Mergermarket, *Global & Regional M&A Report 2018*, page 5.

[17] Mergermarket data. The number of LBOs with a deal value in excess of $1 billion in 2018 was more than 20 percent higher than in 2017 and more than 50 percent higher than the average number in the five year period ending 2017.

[18] Including Carlyle's announced acquisitions of Nouryon (divison of Akzo Nobel) and a stake in Ant Financial Services Group (China) as well as Blackstone's acquisition of a 55 percent stake in Refinitiv (US) (Source: Mergermarket).

[19] Financial Times, *"Private equity spending pace slows to 10-year low"*, 26 December 2018, with reference to data from eFront (www.efront.com).

[20] McKinsey & Company, *supra* note 20, page 23, exhibit 10.

[21] Financial Times, *"Buyouts at risk as leverage loan market wobbles"*, 14 December 2018.

[22] Activist Insight, *The activist investing annual review 2019*, page 10.

M&A transaction (64 percent in 2017) vs. 33 percent of campaigns were they opposed a bid for or by a company (36 percent in 2017).[23]

However, global M&A deal making decelerated sharply in the final two quarters of 2018 from the record pace still seen at the beginning of the year, down significantly from each of the first and second quarters, when \$1.2 trillion worth of transactions were announced in each quarter.[24] In particular, very few large transactions with deal values of greater than \$10 billion were announced during the second half of 2018.[25] This appears to be a consequence of the afore-discussed market turbulence and correction since the beginning of October, and related increases of doubts and uncertainty amongst decision makers. It is especially true of transactions in which a meaningful part of the consideration was intended to include shares of the acquirer, such as mergers of equals ("MoE").

IV. M&A activity and trends since the financial crisis (2009-2018)

M&A occurs in cycles, or waves, when companies react to external "shocks" (economic, financial, technological or regulatory).[26] Their strength and duration depends on the availability of capital to sustain them.[27] The two previous cycles (1995-2000; 2003-2007) were influenced by strong economic growth or recovery, technological change (the internet, 1995-2000) and strong demand for industrial products and infrastructure projects resulting in high prices for commodities (2003-2007). They were mainly driven by large-scale industry consolidation (e.g. telecom, mining), corporate cross-border and leveraged transactions.

1. Market data and trends

The current market cycle can be divided into two distinct parts. The first part started in 2009 and lasted until 2013; the second part began in 2014. While during the first part of the current cycle, global annual deal value remained somewhat depressed, it recovered strongly thereafter, and rose from \$1.91 trillion in 2009 to \$4.02 trillion in 2018, with an interim peak value of \$4.25 trillion in 2015.[28] The second part of the recent M&A cycle benefitted from extremely favourable

[23] Activist Insight, *supra* note 22, page 10.

[24] Thomson Reuters, *Mergers and acquisitions review – First half 2018*, page 1.

[25] JP Morgan Chase & Co., *supra* note 8, page 2.

[26] M. DePamphilis, *Mergers, Acquisitions and Other Restructurings,* 5th Edition, 2010, page 13; R. Bruner, *Applied Mergers &Acquisitions,* 2004, pages 69-97; Brealey and Myers, *Principles of Corporate Finance*, 6th Edition, 2000, pages 967-970.

[27] M. DePamphilis, *supra* note 26.

[28] Thomson Reuters, *supra* note 11, page 1. Global annual deal value has been calculated based on data in figure "Worldwide Announced Buyside Financial Sponsor Activity" (total annual financial sponsor value divided by share of total global M&A).

"goldilocks" type global economic and financial market conditions. The term “goldilocks” refers to healthy economic growth, moderate inflation, persistently low interest rates and low equity market volatility. As a result, global public equities enjoyed one of the longest bull markets in modern financial market history.

Large transactions, with a deal value of greater than $5 billion, rose from an average of less than 27 percent of global deal value during the earlier period to approximately 36 percent thereafter.[29] They included a significant number of MoEs, which will be discussed in more detail further below.[30]

An increase of the share of large deals during periods of strong equity market performance and deal activity occurred also in previous cycles. Conversely, activity in these deals tends to be more strongly affected by market downturns and bad sentiment. It is therefore not surprising that the pace of growth of large strategic activity (deals over $30 billion in transaction value) has slowed in the second half of 2018, as a result of increased political uncertainty. Some observers believe that such deals are more likely to be intracontinental in nature, at least in the near term.[31]

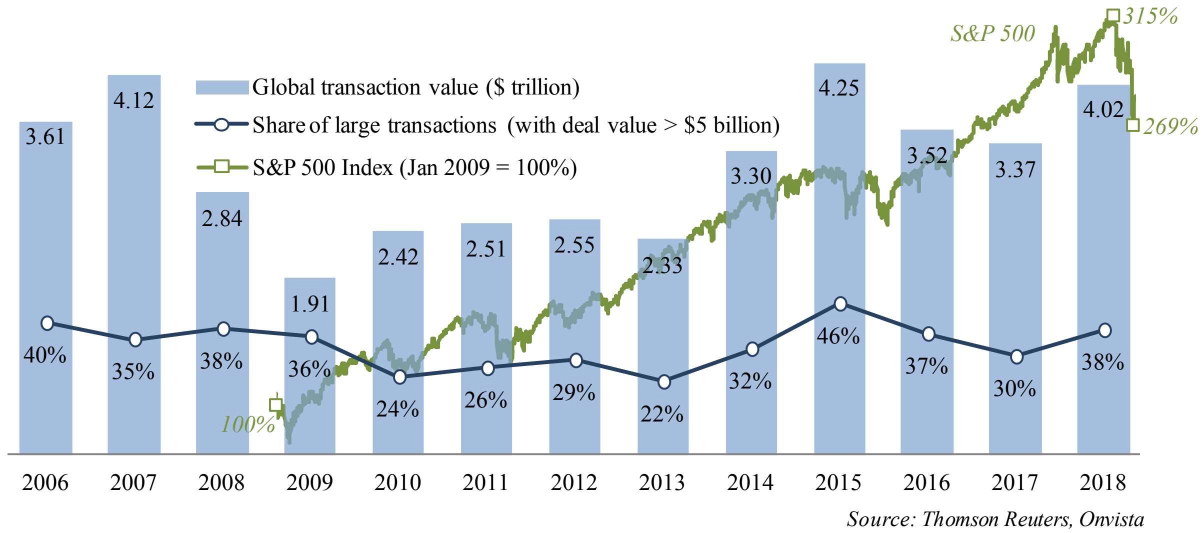

Figure 4: Global M&A transaction data and S&P 500 Index

The share of cross-border transactions was surprisingly consistent throughout, accounting on average for just over a third (35.3 percent) of global deal value during the ten year period under

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[29] Thomson Reuters, *supra* note 11, page 1.

[30] For details on MoEs please see chapter IV 2 a); A. Georgieff/S. Latsky, *“Merger of Equals” Transactions – An Analysis of Relevant Considerations and Deal Trends*, Working Paper No 153, Institute for Law and Finance, Goethe University Frankfurt.

[31] Citigroup Global Markets, Inc., *The Return of Consortium LBO Deals?*, October 2018, page 5.

review.[32] However, Chinese outbound M&A activity, which reached an estimated $250 billion in 2016, halved to only $130 billion in 2018.[33]

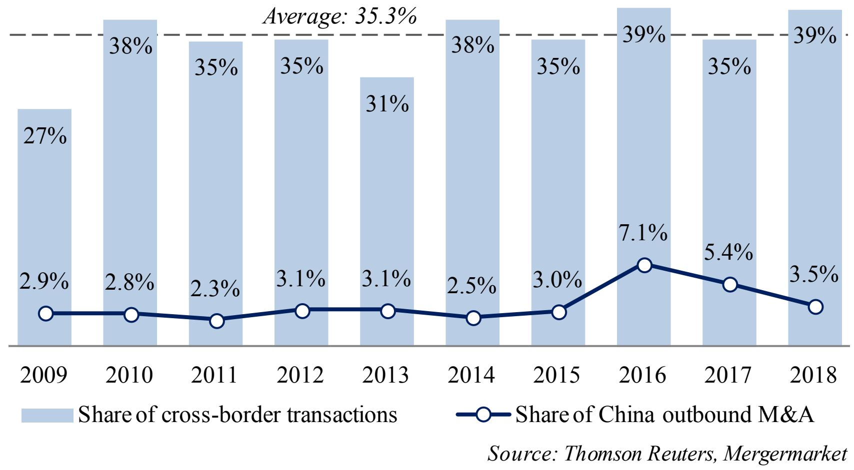

Figure 5: Share of cross-border transaction value and share of China outbound M&A transaction value of global M&A transaction value

Private equity's share of M&A rose steadily from $132 billion or seven percent of global M&A value in 2009 to an estimated $812 billion or 20 percent in 2018.[34] Its "dry powder" at the end of 2018 is estimated to have reached $2.0 trillion of private capital, of which $1.2 trillion private equity, thereof an estimated $700 billion for buyouts.[35]

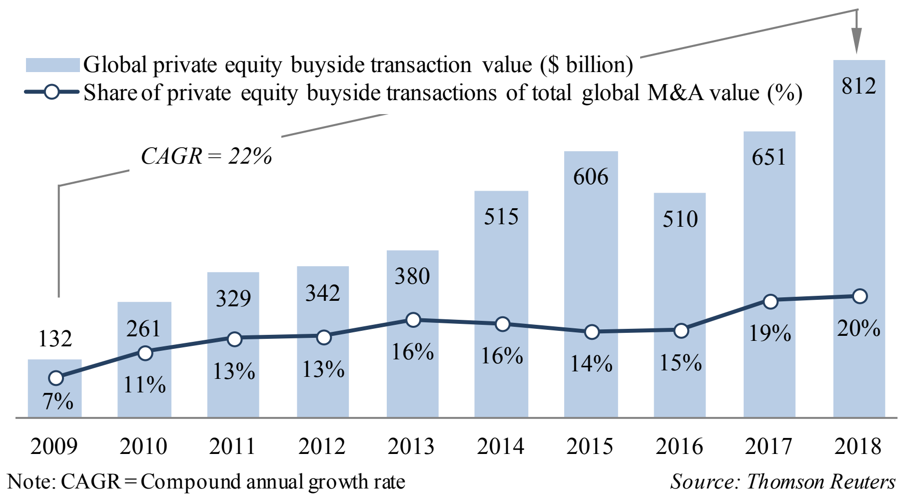

Figure 6: Global announced private equity buyside M&A transaction value

[32] Thomson Reuters, *supra* note 11, page 1.

[33] Infra figure 10; Mergermarket data; JP Morgan Chase & Co., *supra* note 8, page 16.

[34] Thomson Reuters, *supra* note 11, page 1.

[35] Bain & Company, *supra* note 35, page 8, Figure 1.6; Preqin, *Alternatives in 2019: Private Capital Dry Powder Reaches $2tn*, 28 January 2019.

Activist campaigns saw a strong resurgence after the financial crisis and activist funds enjoyed high inflows, from $144 billion assets under management ("AuM") in 2013 to $190 billion AuM in 2018.[36] The number of campaigns rose from 607 in 2013 to well over 900 in 2018.[37] M&A related activism grew even faster: Campaigns, which pursued an M&A related objective, doubled from 94 in 2013 to 216 in 2018.[38]

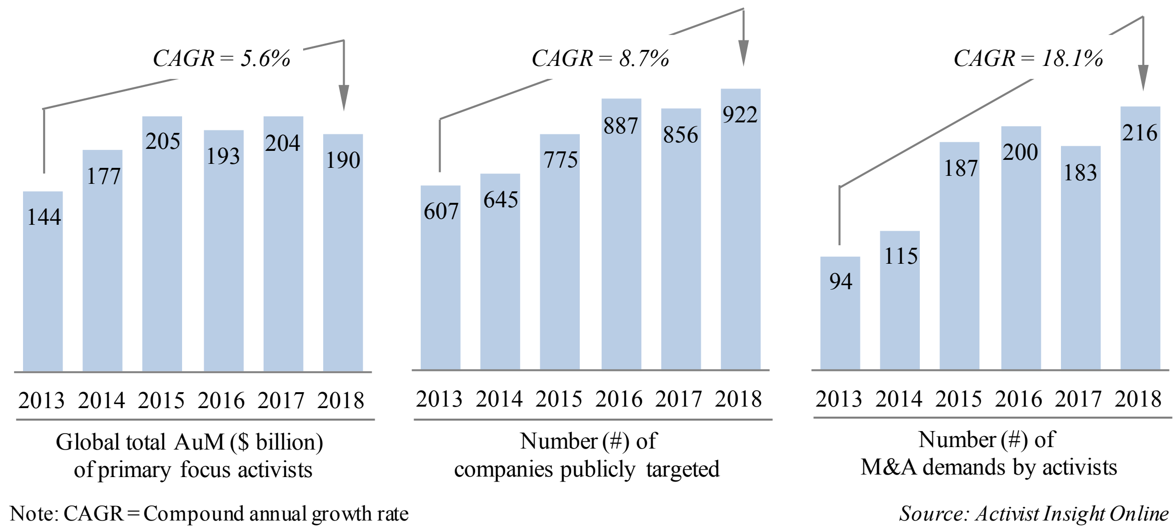

Figure 7: Global activities by activist investors

However, activist investors' returns suffered in 2018. The Activist Insight Index' net return fell below the total return of the S&P 500 Index, which is putting pressure on activist investors to improve their performance in order to retain investor capital.[39]

2. *Important M&A market themes and drivers*

a) *Transformational transactions*

The latter part of the recent M&A market cycle saw a large number of so-called transformational transactions that "change the very nature and operation of a company"[40]. The description of a transaction as "transformational" is frequently given to deals with a very high value. However, it also implies a strategic paradigm shift and significant consolidation effects, such as on the size and scope of the acquiring or merging company's business operations, on its business model or its

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[36] Data received directly from Activist Insight Online following a request by the authors.

[37] Activist Insight, *supra* note 22, page 6.

[38] Activist Insight, *supra* note 22, page 10.

[39] Activist Insight, *supra* note 22, page 31.

[40] www.divestopia.com.

capacity to innovate. A transaction may also be transformational because of its effect on market(s) and consumers. A MoE qualifies very often as a transformational transaction, even though it is primarily defined with reference to its ownership, governance and communication related features rather than its financial effects.[41]

The most recent generation of transformational business combinations was mainly triggered by their promoters' desire to balance declining organic revenue and margin growth, typical of a late business cycle, with synergy-related efficiency gains. They were also a response of established businesses to the disrupting effects of new technologies or business models.[42] Examples are various mergers in the agrochemicals and industrial gas industry, the ongoing consolidation process in the stationary retail industry, and prospectively, further combinations in the car industry, amongst others.[43]

Mergers and acquisitions completed during the last ten years, whose value exceeded $5 billion, $10 billion or $25 billion, amounted to 473, 208 and 75, respectively.[44] A significantly higher percentage of these transactions – 56 percent vs. 44 percent – took place during the second part of the cycle.[45]

During the entire cycle, a total of 120 MoE transactions were completed, of which 40, 27 and 13 deals exceeded a value of $5 billion, $10 billion and $25 billion respectively.[46] While large M&A deals with a transaction value in excess of $5 billion declined sharply during the second half of 2018 (as previously mentioned), MoEs had peaked already in 2016.[47]

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[41] A. Georgieff/S. Latsky, *supra* note 30, chapter II.

[42] "The global economy is in the midst of a fourth industrial revolution that is transforming the business landscape and disrupting virtually every segment of the global economy. (..) Over the past five years, the technology sector has experienced sizeable equity market share gains at the expense of virtually every other sector of the global economy. (..) As the need to address technological challenges accelerates and organic means of innovation become progressively more difficult, M&A can be an important component of the underlying strategy for managing disruption." Citigroup Global Markets, Inc., *Disruptors At The Gate - Strategic M&A For Disruptive Innovation*, April 2018, pages 5, 7 and 9. See also Bain & Company, *supra* note 8, pages 5, 10-11 and 15.

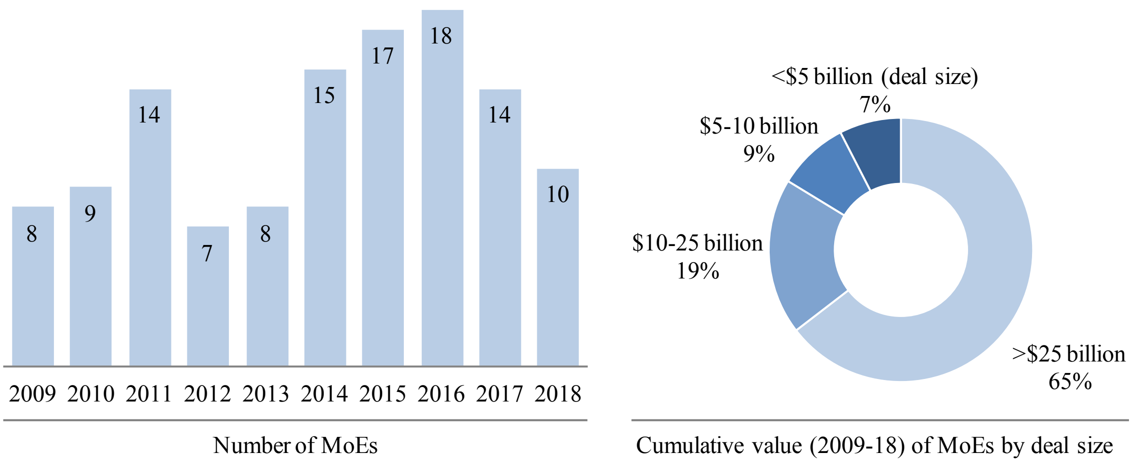
[43] Examples include, inter alia, the merger of Dow Chemical and Dupont (completed in 2017), ChemChina's takeover of Syngenta (2017), Bayer's takeover of Monsanto (2018), the merger of Linde and Praxair (2018), Air Liquide's takeover of Airgas (2015), Linde's takeover of BOC (2006), the merger of Kaufhof and Karstadt (2018/2019).

[44] Mergermarket data.

[45] Mergermarket data.

[46] A. Georgieff/S. Latsky, *supra* note 30, page 20, appendix 4; own research and analysis.

[47] Thomson Reuters, *supra* note 11, page 1; JP Morgan Chase & Co., *supra* note 8, page 2.



Source: Own research

Figure 8: Globally announced mergers of equals

The headwind for large-scale, strategic combinations is expected to remain strong. On the other hand, it is quite possible that there will be more large acquisitions or recapitalisations of both private and public (including technology) companies by buyout firms.[48] This is influenced by a growing availability of sizeable target companies, so-called unicorns[49], which seek to either stay or go private to avoid the inconveniences of a public listing and meet the investment criteria of private equity investors.

b) Cross-border M&A

M&A transactions are defined as "cross-border" when they involve parties from different countries (or touch different, often multiple jurisdictions). Strong cross-border business activity, including M&A, is expected to be the norm in a global economy, which is characterised by largely unrestrained flows of information, goods, services and capital, as well as easy logistics and travel. Companies expand their international footprints in order to grow their business presence in foreign markets and to diversify their input sources and production facilities. This is reflected in their corporate development strategies and investment plans, with a significant share of resources frequently allocated to (cross-border) M&A.

[48] Citigroup Global Markets, Inc., *supra* note 31, page 6.
[49] A "unicorn" is a startup company with a value of over $1 billion (www.investopedia.com).

Cross-border M&A is significant, can be disruptive, can be driven by factors that are different from domestic transactions and entails an evaluation of country-specific risk factors.[50] We have seen that during the last decade, cross-border deals accounted for approximately a third (by deal value) of global announced M&A, their share barely changing from year to year.[51] The cross-border share of large transactions was even higher; it amounted to more than 45% percent for deal values of $5 billion and above.[52]

Many transactions had an emerging market angle, where either the buyer or seller of a company was based in an emerging market country (of these, a large number were cross-border deals). Their share of global announced M&A (by deal value) was significant and ranged from 24 percent to 33 percent.[53]

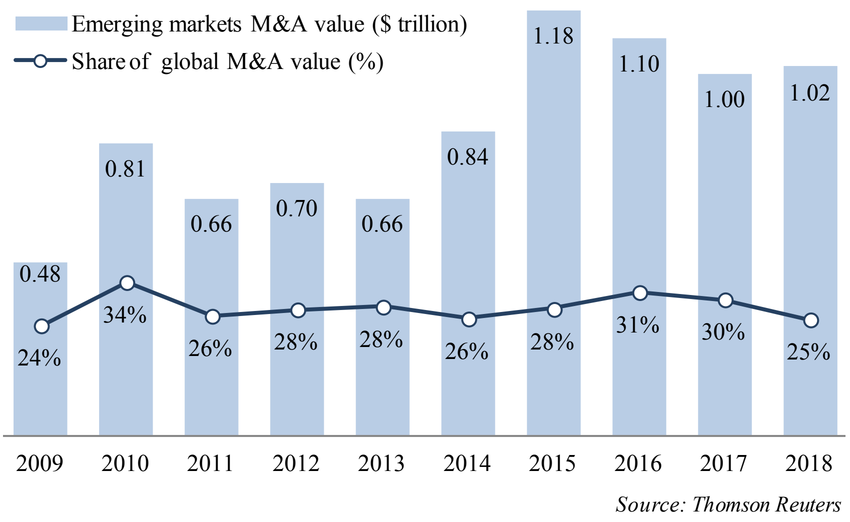


Figure 9: Emerging markets M&A value

China was by far the most important emerging market M&A target nation. Total annual cross-border M&A deal values involving a Chinese target company exceeded the corresponding values of inbound M&A transactions in any other emerging market country in each of the last ten years.[54] China outbound cross-border M&A also increased strongly during the last decade. It peaked in 2016, when it accounted for more than 80 percent of all cross-border M&A involving a Chinese entity.[55] During this period, Chinese investors and companies invested in, or acquired, many

[50] R. Bruner, *supra* note 26, p. 98-108.

[51] Thomson Reuters, *supra* note 11, page 1; supra figure 5.

[52] Mergermarket data.

[53] Thomson Reuters, *Emerging markets M&A review – Full year 2018*, page 1.

[54] Moody's Corporation, Bureau van Dijk, *Global M&A Review 2018*, pages 5 and 7.

[55] Thomson Reuters, *supra* note 11, page 15.

businesses in developed countries, across a broad range of industries, but focused mainly on new or advanced technologies, strong brands and trophy properties.[56] Their interest was welcomed and often actively solicited by sellers of companies, because they were perceived to be willing to offer premium prices to secure an asset.

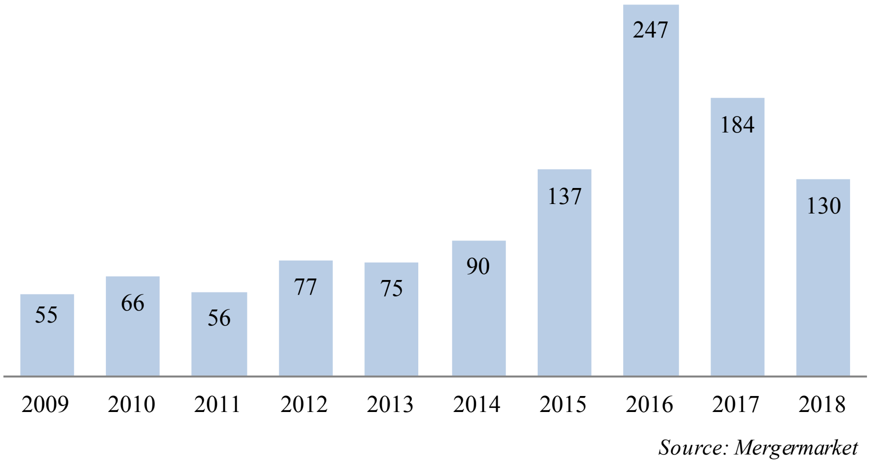


Figure 10: China outbound M&A value ($ billion)

Since then, China cross-border M&A has slowed, due to a combination of economic and political reasons:

Firstly, China has begun the transition from an export-led economy, based on its former comparative advantage in producing goods more cheaply, towards a more balanced, services and consumption-led economy. It now emphasises the development of knowledge and innovation based industries for the creation of jobs and wealth, in order to stimulate domestic consumption. As a consequence of this, its trading surplus has shrunk and the value of its currency, relative to the US dollar, has declined. In order to reduce the outflow of capital, it has imposed curbs on foreign investments and acquisitions by Chinese investors that do not serve the afore-mentioned purposes.[57]

Secondly, the governments of many developed countries are increasingly concerned about the lack of reciprocal market access and slow progress in removing legal and administrative barriers to foreign direct investments in China, especially in industries perceived to be of a strategic or sensitive nature by the Chinese government. They also complain about interference by the Chinese government in these industries and related markets, by directly or indirectly supporting Chinese

[56] Morning Whistle Group, *A Review of Chinese Outbound M&As in 2017-2018 and Outlook*, pages 5-8.

[57] E. Matsangou, *China's transitioning economy*, www.worldfinance.com, 23April 2018; Dieppe/Gilhooly/Han/Korhonen/ Lodge (editors), *The transition of China to sustainable growth - Implications for the global economy and the euro area*, European Central Bank, Occasional Paper Series, No. 206, January 2018, pages 30-36 (34).

competitors, and fear its ability to influence these companies' activities and to potentially access their technologies, infrastructure and/or data networks for other purposes. This has led the US and other developed market governments to block Chinese investors from acquiring interests in companies whose operations are deemed to be sensitive to their national interest and/or security.[58]

However, challenges for cross-border M&A have increased and are not restricted to commercial relations with China. The global geopolitical climate has changed quite dramatically. Popular concerns about the effects of economic and financial globalisation, climate change and mass migration have created an atmosphere of anger and fear in many developed countries, fostering tribal instincts opposed to open societies and economies. They lead to national, rather than multinational, policy solutions, such as the proliferation of protectionist laws and administrative measures, including the possible increase of government intervention in planned or announced cross-border M&A transactions for political rather than market related purposes.[59]

c) Leveraged buyouts

Buyouts have continued to outperform public equity markets during the last ten years, albeit at a declining rate.[60] Their performance is perceived to be less volatile than investments in the public markets or in some other types of private assets.[61]

This explains why investors keep allocating a significant part of their private market commitments to buyout funds. Recent investor surveys indicated that most investors intend to either increase or maintain their allocations to private equity (split roughly 50/50),[62] even though fundraising in 2018 was slightly down from 2017.[63] The largest and most established institutional investors in private equity continue to seek larger, more strategic relationships with fewer managers. As in the world of public equities, both funds raised and capital managed (assets under management and committed capital) appear to become more and more concentrated amongst a smaller number of large private equity firms.[64]

[58] Supra chapter IV, 3. An example relates to the security concerns regarding Chinese telecom equipment company Huawei's role as a supplier of 5G equipment in the US and in Europe (The New York Times, *Huawei and ZTE Hit Hard as U.S. Moves Against Chinese Tech Firms*, 17 April 2018).

[59] Supra chapter IV, 3.

[60] Bain & Company, *supra* note 35, page 33, Figure 1.28.

[61] JPMorgan Chase & Co, *Thanksgiving eye on the market*, November 2018, page 3-4. For a detailed explanation of the mechanics of leveraged buyouts, please refer to A. Georgieff/M. Biagosch, *Finanzierungsinstrumente von Finanzinvestoren*, in: Unternehmensentwicklung mit Finanzinvestoren, 2005, pages 171-209.

[62] JPMorgan Chase & Co, *supra* note 61, page 7; Bain & Company, *supra* note 35, page 75, Figure 3.2.

[63] Bain & Company, *supra* note 35, page 21, Figure 1.18.

[64] McKinsey & Company, *The rise and rise of private markets*, Global Private Markets Review 2018, page 13-14.

Estimates of "dry powder" for LBO (and other private equity) investments have increased every year,[65] but are believed to be somewhat overstated due to the increased use of subscription loans.[66] These loans are used to bridge-finance investments and are ultimately repaid by drawing down investor fund commitments (capital calls). They are intended to boost investment returns, according to various estimates, by up to three percent per annum.[67] Nonetheless, the amount of "dry powder" available for private equity investments is very substantial and it will continue to rise for as long as fundraising exceeds deployment of capital. Since 2015, fundraising for private equity funds amounted to more than $600 billion each year, of which a significant share related to buyouts.[68]

As long as the leveraged finance market remains open and acquisition debt is cheap and offered on advantageous terms (as it was during most of this cycle), total funds available for LBOs will significantly exceed total private equity fund commitments, despite bank regulators' efforts to impose limits on leveraged lending, and hence provide LBO funds with tremendous "firepower".

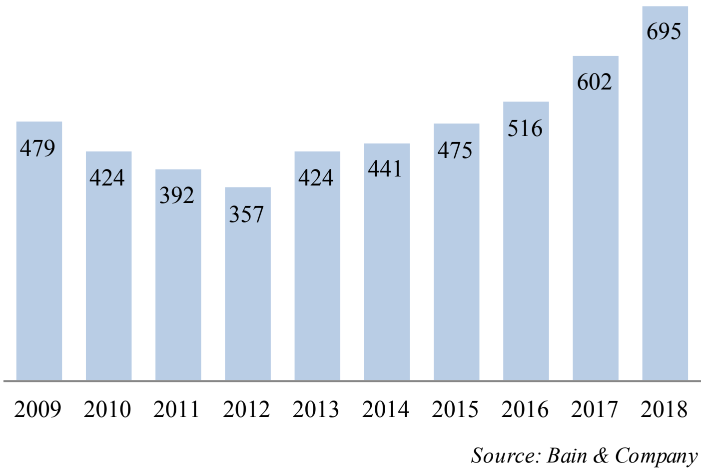


Figure 11: Uncalled capital of global private equity buyout funds ($ billion)

So it seems the rise of private equity, including LBOs, is unstoppable, or is it? LBO fund managers are now faced with the twin challenges of high valuations and scarcity of investment opportunities. Buyout purchase price multiples have increased significantly since 2009,[69] while LBOs' share of global M&A by deal count (rather than to deal value) has started to decline.[70] With global economic

[65] Bain & Company, *supra* note 35, page 8, Figure 1.6.
[66] JPMorgan Chase & Co, *supra* note 61, page 6.
[67] JPMorgan Chase & Co, *supra* note 61, page 6.
[68] Bain & Company, *supra* note 35, page 21, Figure 1.18.
[69] McKinsey & Company, *supra* note 20, page 23, exhibit 10; Bain & Company, *supra* note 35, page 10, Figure 1.9.
[70] Bain & Company, *supra* note 35, page 5, Figure 1.3.

growth projected to slow, monetary stimulus measures ending and public equity multiples unlikely to expand further in the near and medium term, returns from buyouts are expected to trend lower, absent a major correction of the valuations of public and private equities.[71] Regardless of this anticipated development, an unprecedented amount of capital continues to chase a limited number of opportunities. Four types of LBO strategies appear to have been facilitated by these developments:

First, so called “buy and build” acquisition strategies, in which a buyout firm grows a portfolio company (“platform”) through acquisitions. Platform strategies are not only intended to create value through accelerated growth, but also seek to benefit from the synergies associated with add-on acquisitions. They help to justify a higher purchase price multiple for the initial platform company and result in a lower blended entry multiple. Highly popular amongst buyout firms, the employment of this strategy rose from 34 percent of all private equity transactions in 2009 to a high of 45 percent in 2018.[72]

Second, “secondary” buyouts, i.e. sales from one buyout firm to another. Their share, relative to other types of LBOs, has increased over the years.[73] The inclination towards secondary buyouts is believed to be strongest amongst firms with the greatest pressure to transact (both, as buyers or as sellers). However, various academic studies have shown that the performance of secondary (or even subsequent) buyouts tends to be lower than that of primary buyouts (although their returns are often perceived to be more predictable).[74]

Third, “public to private” transactions ("P2P"). High LBO purchase multiples have triggered an increase of P2Ps, as the number of public companies trading at lower valuations relative to private market multiples has risen.[75] As a result, 166 P2P transactions were announced globally in 2018 (152 in 2017 versus an average of only 107 deals during the preceding eight years.[76]

Fourth, buyouts of technology companies, which were previously deemed unsuitable as buyout targets because their cash generation was typically insufficient and unstable, and their sales growth too unpredictable. However, with the renewed availability of substantial amounts of venture and growth capital, from a variety of sources (traditional venture and growth capital funds, hedge funds,

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[71] Bain & Company, *supra* note 35, page 33.

[72] McKinsey & Company, *Private markets come of age,* Global Private Markets Review 2019, page 25.

[73] JP Morgan Chase & Co, *supra* note 61, pages 3 and 13.

[74] JP Morgan Chase & Co, *supra* note 61, page 13.

[75] Bain & Company, *supra* note 35, p. 77, Figure 3.4.

[76] Bain & Company, *supra* note 35, p. 7, Figure 1.5.

corporate and sovereign investors), technology companies can now grow and stay private longer. Depending on their business model, they promise not only fast, but also predictable growth (e.g. subscription-based software as a service (SaaS)). LBOs of technology companies rose from 18 percent in 2009 to 34 percent in 2018.[77]

The LBO industry has gone from strength to strength during the last ten years. However, prices for private equity secondaries (i.e. the purchase of limited partnership (fund) interests) have recently softened.[78] It remains to be seen whether this is a first sign of a cooling of an "exuberant" market or only a reflection of the public equity market dips in October and December of 2018.

d) Shareholder activism

Shareholder activism, also known as activist investing, is a strategy which is most prominent within the US, and the vast majority of known institutional investors in activist funds are based in North America. [79] However, it is a strategy that is now also frequently applied outside the US. The increased size of activist funds and their successes have created a virtuous circle that has allowed activist investors to target larger corporations in which to invest.[80]

European companies are also frequent targets of activist campaigns, attracting on average 17 percent of global activist activity.[81] The amount of activist capital invested in Europe reached nearly 57 percent of the corresponding amount invested in US companies from January 2014 till September 2018.[82]

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[77] Mergermarket data.

[78] PEFOX, *Secondaries Market Comment*, Q4 2018 (www.pefox.com).

[79] An activist investor is “an individual or group that purchases ... a public company’s shares and/or tries to obtain seats on the company’s board with the goal of effecting a major change in the company. A company can become a target...if it...has a problem that the activist investor believes it can fix to make the company more valuable.” (www.investopedia.com). For a more detailed discussion of shareholder activism, please refer to: *“Capitalism's unlikely heroes"*, in The Economist, 7-13 February 2015; D. Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, Virginia Law & Business Review, Vol. 7:3 (2013).

[80] The world's largest companies by market capitalisation are now within the reach of activist investors. This is illustrated by Carl Icahn's investment in Apple (2016-2018) and Third Point's current investment in Nestle, which were/are at the time of these investments the most valuable US and European company, respectively.

[81] Activist Insight, *Activist investing in Europe 2018*, page 5; H. Bader/A. Georgieff, *Shareholder Activism in Germany: Similar but different*, International Bar Association, Corporate and M&A Law Committee newsletter article, June 2015.

[82] Activist Insight, *Activist investing in Europe 2018*, page 19. During the period 1 January 2014 and 30 September 2018 the value of newly disclosed activist investments at Europe- and U.S.-headquartered companies with a market cap over $200 million amounted to $103 billion (Europe) and $181 billion (US) respectively.

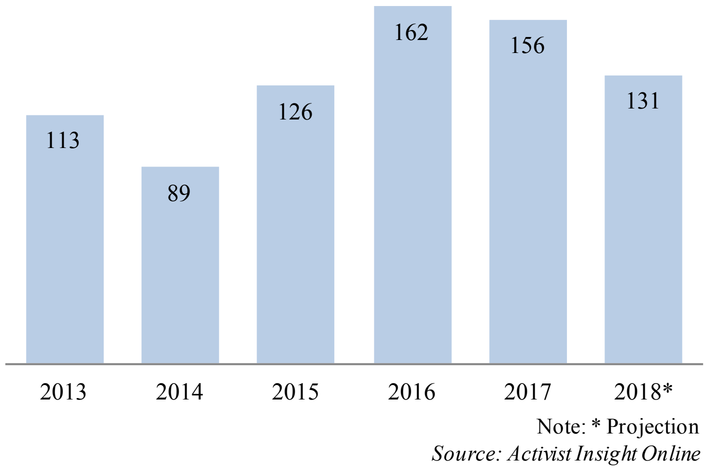

Figure 12: Number of European companies publicly targeted by activist investors

M&A has become an important objective of activist campaigns. Activists advocate for the sale or spin-off of a division when they are convinced it no longer fits, does no longer add value and therefore ties up capital that can either be better employed elsewhere or should be returned to shareholders.[83] They also oppose or even intervene in M&A bids which they don't perceive to be value accretive (as bidder shareholder) or to represent full value for their shares (as target shareholder). It must be expected therefore that activist demands or intervention will remain a key consideration for corporate M&A strategy and will continue to strongly influence deal dynamics and outcomes going forward.

This became also apparent in the large number of carve-outs which were announced in recent years.[84] Corporate boards, under pressure from activist or in anticipation of their demands, sought to simplify their business structures and portfolios by exiting non-core businesses. Through greater focus and clarity, companies are expected to improve their performance and share ratings in order to reduce their cost of capital. This shift towards de-conglomerization was illustrated by the recently announced break-up of General Electric.[85] It is also a key theme in Germany, where many DAX companies announced important restructurings and carve-outs (e.g. Continental, Daimler, EON/RWE, Siemens, ThyssenKrupp).

[83] S. Chen/E. Feldman, *Activist-Impelled Divestitures and Shareholder Value*, Strategic Management Journal 39 (10), pages 2726-2744.

[84] JP Morgan Chase & Co., *supra* note 8, page 8.

[85] Bloomberg, *GE Gives Investors a Breakup (...)*, 26 June 2018.

Activists are now more frequently supported by institutional shareholders who commit considerable resources to issues relating to corporate governance.[86] Their increasing openness to activist demands is of great relevance, especially since (institutional) ownership of public companies has become more concentrated. As per October 2018, the top five investors collectively owned almost 25 percent of the S&P 500 Index. Similar levels of ownership concentration can also be observed in other important equity markets. This trend is supported by persistently strong fund flows from active managers to a small number of very large passive managers whose share of managed public equities is fast approaching 50 percent in major regional equity markets.[87] When one also considers that the two leading proxy advisory firms issue voting recommendations to owners of an estimated 25-35 percent of global equities (including the afore-mentioned),[88] it becomes apparent that only few players in the equity markets wield enormous influence and hold an increasingly important role as “power brokers“ in proxy fights, including battles for corporate control.

3. Merger control, national security and government intervention

There is a general perception that governmental scrutiny of M&A transactions, which has led to deal concessions, abandonment or prohibition, has increased with an expectation that this will continue. It is caused by worsening international trade relations, including the afore-discussed trade dispute between the US and China, and efforts by legislators around the world to introduce new laws that restrict cross-border investments.[89]

However, intervention by regulatory or other governmental agencies has not yet materially increased. Although the number of significant EU merger control investigations has steadily climbed from 11 in 2011 to 29 in 2018, only few proposed combinations were withdrawn and/or prohibited.[90] In the US, the number of investigations has even declined, after a few years of

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[86] Barron’s, *Passive Investors Are the New Shareholder Activists*, 8 July 2017, www.barrons.com.

[87] Ownership concentration, even at very large public companies, is the result of, inter alia, the continuous institutionalisation and consolidation of the asset management industry as well as rapid growth of passively investing, low cost index funds. These funds have benefitted from substantial capital inflows in recent years, at the expense of active managers. Total funds flowing from active to passive investment managers during the past decade (2007-2017) are estimated at approximately $1.4 trillion (Morningstar, Direct Asset Flow 2017).

[88] T. M. Doyle, *The Conflicted Role of Proxy Advisors*, American Council for Capital Formation, 22 May 2018; Institutional Shareholder Services Inc (ISS), *Continental Europe Proxy Voting Guidelines*, 6 December 2018, pages 26-27; Glass Lewis & Co., *2018 Proxy Paper Guidelines United States*, pages 39-45.

[89] *Germany lowers thresholds for review of foreign investment*, 12th Ordinance Amending the German Foreign Trade Ordinance (Außenwirtschaftsverordnung, AWV), 19 December 2018; Handelsblatt, *Berlin will Übernahmen deutscher Firmen aus dem Ausland erschweren*, 16 December 2018 and very detailled in V. Günther, *Der Vorschlag der Europäischen Kommission für eine Verordnung zur Schaffung eines Rahmens für die Überprüfung ausländischer Direktinvestitionen in der Europäischen Union*, Beiträge zum Transnationalen Wirtschaftsrecht, Heft 157, August 2018.

[90] Dechert LLP, *DAMITT 2018 Year in Review*, Figure “Significant EU Antitrust Investigation Outcomes (2011-2018)”.

increased activity towards the end of the Obama presidency.[91] In each of 2017 and 2018, only one transaction was abandoned due to regulatory concerns.[92]

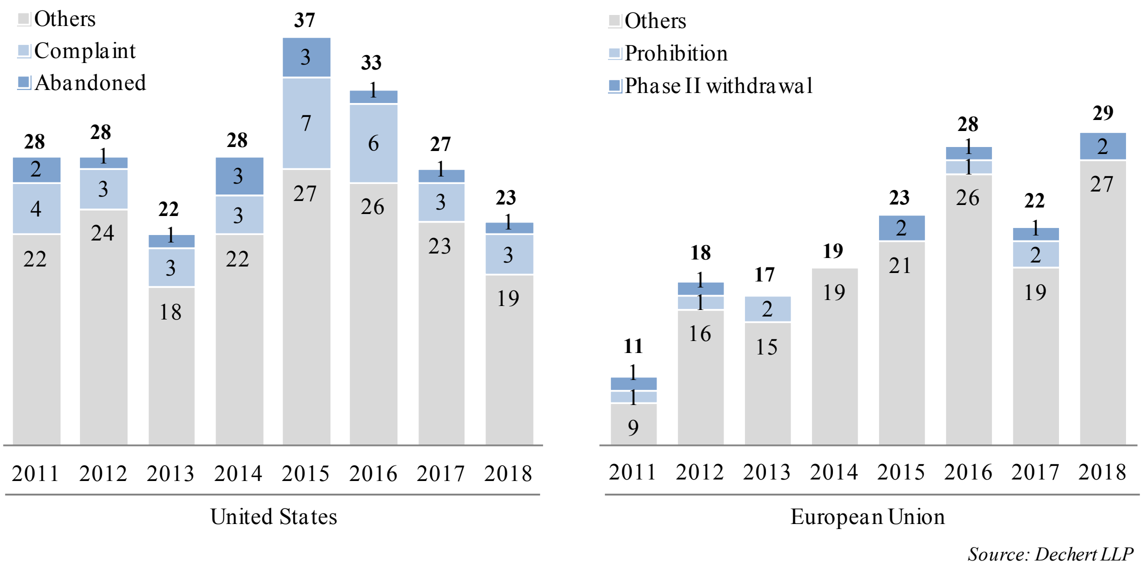

Figure 13: Significant US and EU antitrust merger investigations

On the other hand, national security issues play an increasingly important role in cross-border M&A. CFIUS[93] filings have significantly increased from 65 in 2009 to 240 in 2017, even though US administrations have blocked only five transactions (including the proposed takeover of German company Aixtron by a Chinese bidder) since the creation of CFIUS in 1975 (subsequently amended in 1988, 2007 and 2016).[94]

Many observers fear that future government action may undermine merger review processes due to conflicting political objectives. This is illustrated by the strong lobbying efforts of the French and German governments in support of the proposed merger of the rail activities of Alstom and Siemens to create a "European champion“ better able to compete with its state-funded Chinese rival, which the EU Commission resisted.[95] The Commission based its decision to prohibit this transaction solely on the proposed combination's expected anticompetitive effects and rejected any industrial political considerations and related intervention to justify an exemption as falling outside the scope

[91] Dechert LLP, *supra* note 90, Figure “Significant U.S. Antitrust Investigation Outcomes (2011-2018)”.

[92] Dechert LLP, *supra* note 90, Figure “Significant U.S. Antitrust Investigation Outcomes (2011-2018)”.

[93] Committee on Foreign Investment in the United States. CFIUS is an inter-agency committee of the United States Government that reviews the national security implications of foreign investments in US companies or operations.

[94] J. Masters/J. McBride, *Foreign Investment and U.S. National Security*, Council on Foreign Relations, 28 August 2018; T. Heinrich/F. Jalinous/J. Staudt, *“Chinese Walls” – Grenzgänge zwischen nationalen Sicherheitsinteressen und Technologie-Protektionismus*, Die Aktiengesellschaft, 5/2019, pages 146-148.

[95] Financial Times, *Germany pushes for an EU industrial policy revolution*, 6 February 2019; Financial Times, *France calls for biggest shake-up of EU merger rules in 30 years*, 12 February 2019.

of competition policy.[96] It remains to be seen how long the Commission will be able to maintain its stance in the face of growing interventionist trends, political pressure and possible legislative changes.

V. Concluding remarks

The previous M&A cycles (1995-2000; 2003-2007) witnessed some very large, potentially transformational, but also very unsuccessful M&A transactions and M&A related corporate failures. The two largest transactions in history, the takeovers of Mannesmann by Vodafone in 1999/2000 and Time Warner by AOL in 2000, resulted in massive destruction of shareholder value.[97] The same was true of the merger of Daimler and Chrysler in 1998, which was subsequently unwound in 2007.[98] AOL/Time Warner and Daimler/Chrysler were labelled as MoEs, but their outcomes caused this type of transaction long-lasting reputational damage.[99] The past cycles also saw the implosion or break-up of some very large companies (Enron, WorldCom, Tyco), which had pursued aggressive acquisition strategies by using their highly valued shares as consideration. Yet in each case, shareholders had strongly supported the transaction(s) and underlying strategy, despite their subsequently apparent flaws.

In contrast, during the current cycle acquirers appear to have avoided such errors, and resulting large scale failures by applying greater strategic and financial discipline. They may have been guided by lessons from badly planned and executed deals in the past, but their prudence was also induced by more restrictive rules on corporate governance, stronger scrutiny of corporate transactions by leading institutional investors and the influence of activist shareholders. They were also mindful of their fiduciary duties, in particular their duty of care, which is evident in the now widely established use of fairness opinions,[100] also for non-US transactions,[101] and the important exceptions to the Delaware-style business judgment rule.[102]

However, recent transaction trends suggest that corporate boards are once again willing "to push the envelope" when exploring acquisition or merger opportunities. They are motivated to do so by

[96] European Commission, press release IP/19/881, *Mergers: Commission prohibits Siemens' proposed acquisition of Alstom*, 6 February 2019.

[97] The New York Times, Dealbook, *How the AOL-Time Warner Deal Went Wrong*, 11 January 2011; Euromoney, *Vodafone's takeover of Mannesmann: The bid that couldn't fail*, 1 March 2000.

[98] A. Brew, *"Why Corporate Mergers of Equals Almost Never Work"*, Forbes Leadership, 2014.

[99] A. Georgieff/S. Latsky, *supra* note 30, pages 6-7.

[100] A. Georgieff/R. Weber, *Fairness Opinions*, Studien des Deutschen Aktieninstitutes, Heft 52, March 2012.

[101] S. M. Davidoff, *Fairness Opinions*, American University Law Review, Vol. 55, 2006; D. J. Kisgen/J. Qian/W. Song, *Are Fairness Opinios Fair?*, The Case of Mergers and Acquisitions, March 2008.

[102] Smith v. Van Gorkom, 488 A.2d 858, 875 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A2d 946 (Del.Supr.1985); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. Supr.1986).

declining organic growth and margin pressure, and supported by shareholders who tend to attach higher ratings to the shares of faster growing companies. Research shows that although bidders in recent public M&A transactions were required "to pay away" a larger share of projected deal synergies than before, their share price tended to go up following the announcement.[103] This development contrasts strongly with previous experience, when the shares of an acquiring company frequently declined after the announcement of a transaction, and may suggest that acquirers and their shareholders have become too optimistic in their assessment of the likely financial effects of acquisitions.

It is too early to call the end of the current M&A cycle. M&A activity in the US during the first quarter of 2019 recovered strongly from the weak second half in 2018, in line with the global equity market (but deal activity in Europe was overshadowed by the Brexit related drama).[104] Some of the important drivers of M&A during the recent cycle, such as technological disruption and supportive capital markets, are unlikely to change in the near future. However, a slowing global economy, increasing regulatory attention and geopolitical uncertainty should be expected to have negative effects on global M&A deal activity going forward.

[103] Boston Consulting Group, Inc., *The 2018 M&A Report: Synergies Take Center Stage*, 12 September 2018, pages 4 and 10.
[104] Reuters, *Global M&A slides in first quarter as Brexit weighs on Europe*, Business News, 29 March 2019.

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