OnAir with Akin Gump

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Ep. 27: The State of M&A in the UK, Europe and Beyond

February 27, 2020

Jose Garriga: Jose Garriga: Hello and welcome to *OnAir with Akin Gump*. I'm your host, Jose Garriga.

Cross-border mergers and acquisitions have been facing challenging times as recent political change and uncertainty coupled with trade tensions conspired to dampen enthusiasm and deter deal-making.

However, these headline-worthy headwinds notwithstanding, cross-border M&A deal flow has remained resilient.

In this episode, Akin Gump international competition and trade partner Davina Garrod and corporate partner Gavin Weir take a look at how Brexit, trade scuffles and the 2020 U.S. elections are shaping the deal landscape, outline some of the paths the dealmakers have taken or carved out to get transactions done and offer their outlook for M&A in the U.K., Europe and beyond.

Welcome to the podcast.

Davina, Gavin, thank you so much for appearing on the show today.

This is a big topic, so let's dive right in, starting with a bit of background for listeners. Gavin, if you would, what is the current state of M&A in the U.K. and Europe and how is it being shaped by Brexit?

Gavin Weir: Hi, Jose. First of all, thanks very much for having us on the podcast today. The U.K. M&A has seen a dip of about 10 percent in the last two or three years since the Brexit referendum. Interestingly, I think there's a view from many commentators that this is just a coincidence; it's not necessarily directly related to Brexit. The main driver for the uncertainty has been around our Parliament, which has been almost in paralysis because of a minority government, combined with economic uncertainty and a concern in some business circles about the prospect of a left-leaning Jeremy Corbyn government or, indeed, a hung parliament. So, whilst it looks like Brexit or the prospect of Brexit was going to have an effect on the U.K., actually my view is that what was really driving things was the uncertainty in the market. And with the outcome of the recent election in December last year, we now have a very strong government, which happens to be very business-friendly.

So, it looks like the direction of travel is towards some form of deal by the end of 2020 in one shape or another. And I think what most people appreciate is now having some certainty. Many of the commentators that we've spoken to have said that their biggest fear factor, if you like, was the prospect of a Jeremy Corbyn government. Now that that's gone away, interestingly, we've already seen in January and early February of this year a recovery in the U.K. housing market, where there are some anecdotal messages about prices being up relatively dramatically in some parts of prime London, which is usually an indicator that wealthy investors are coming back into the market. So, if that is true, then I think that could be a precursor for a recovery in the M&A market. And, certainly, we are seeing a backlog of deals that could have happened in late 2019 coming up the pipeline for 2020. Davina, are you seeing the same thing?

Davina Garrod: Absolutely, Gavin. You've made some really good points, and it's great that we have political stability at last now until May 2024 with a very pro-business government. So that's one piece of good news at least. And we're now in the U.K. in a Brexit transitional period, which means that we're effectively still in the EU from a regulatory perspective until year-end. And, in the meantime, Boris Johnson is pushing a divergence policy with the EU and aims to play off the EU against the U.S. in trade negotiations later on this year.

Now, it's not clear how this will play out, but what we do know for sure is that the sterling:dollar exchange rate has held below the long-term average for the last few years, making the U.K. a very attractive market for U.S. acquirers in particular. Indeed, the private equity venture capital industry is sitting on cash reserves of approximately $1.45 trillion which they need to deploy. And major recent American acquisitions of U.K. companies include a consortium of largely North American investors acquiring Inmarsat for 4.2 billion pounds and Advent International's 4 billion-pound purchase of Cobham.

Gavin Weir: Davina, it's interesting you're saying that about these U.S. inbound deals into the U.K. because one of the features that we've seen over the last few years in the European M&A market is that the U.K. historically always accounts for somewhere between 30 and 40 percent of all inbound transatlantic M&A from the U.S.A. That has not changed in the last three years since the Brexit referendum, nor do we expect it to change. Interestingly, the statistics show that, although I mentioned earlier on that the U.K. suffered a dip in M&A over the last few years, so did France, Germany, Italy, Spain and other major centers in Europe. That makes me think that any suggestion that there was a dip caused by Brexit, I don't think is right.

And apart from anything else, it's too early to tell because Brexit hasn't really happened yet. Brexit is going to happen really in practical terms at the end of this year, 2020, although officially it happened on the 31st of January. There'll be no real impact in my view during this year, and, if anything, actually, for all the reasons you've just described like foreign exchange—ironically the Eurozone looks like it's dipping just as the U.K. is arguably going to be growing faster—I think there'll be more M&A and more opportunities for M&A in the U.K. with the new political stability than would otherwise have been the case.

Jose Garriga: Thank you, thank you both. So, let's talk, then, about some other issues that might be impinging on M&A and see what kind of impact you all think they might be having. Davina, if you would, economic protectionism, foreign direct investment controls, even climate change—any impact on the dealmaking environment?

Davina Garrod: Absolutely. I mean, Gavin's right about a wider issue with M&A deal flows EU-wide, and I like numbers, so, just looking at the stats here: EU M&A flows were down last year compared with 2018, so, 883 billion euros to 1.08 trillion euros. And, again, political instability in many countries, migration concerns from the Middle East and Africa, and the EU zone elections were key factors.

Climate change, I think, yes, on the margin, now that addressing climate change has finally become a priority of the EU and is diverting management attention in the private sector.

I think it's fair to say that heightened FDI screening and national security reviews are an expression of economic protectionism no matter what the governments in question may say. And in Europe, we now have at least 15 member states reviewing foreign investments, often in sensitive industries such as defense, energy, technology and media—those sectors where we're seeing most growth in M&A inflows. I think the considerable uptick in Chinese FDI, in particular, in 2017, had sparked aggressive scrutiny by the French and the Germans who together pushed for an EU-level screening regime which entered into force last year. And the weaponization of trade vis-a-vis the U.S. and China had fueled a rebalancing of Chinese money towards Europe. Just as Chinese investment fell in the U.S. in 2017, it grew by 73 percent in the EU that year and, as a result, our acquire investor clients now take into account FDI and national security reviews as well as antitrust investigations when negotiating deal structures and timetables.

Gavin Weir: Davina, I think that point you just made is actually really interesting because, whilst for some clients, I think those hurdles caused by geopolitical issues will cause them to not do M&A deals or to walk away from deals that were already on the table, I've seen some situations where some private equity clients have actually actively pursued situations because they've seen an opportunity in the M&A market where they believe that a deal might be perceived as less capable of being done and, therefore, is not attracting as many buyers. And the private equity buyers here willing to spend time and energy finding a structure that works are actually, in their minds, getting a bargain because no one else is looking at it. So, I think it's like everything where there's a challenge, there's also an opportunity.

That's definitely a feature I think we'll see over the next year or two because the bottom line is: No matter what the difficulties caused by, say, short-term trade wars or short-term geopolitics or election cycles, M&A is made on much longer-term strategies, at least as regards corporates. Maybe not with private equity or funds, but I think some of the corporate clients we are speaking to are saying actually notwithstanding all of the media coverage and noise surrounding some of these issues, the long-term five-, 10-, 15-, 20-year plan, if an M&A deal is worth doing in particular circumstances, they're still going to do it even if it's a bit more painful.

Davina Garrod: And then, by the same token, I think the sell side has to do a lot more homework today when preparing an asset, including anticipating potential FDI and antitrust hurdles and preempting any buy-side concerns so as to attract the widest pool of potential buyers. Deals may take longer, but they will get done.

Jose Garriga: Thank you. So, let's cross the Atlantic, then, and look at the extent, if any, that the White House and the Trump administration's policies, particularly on trade and security, might be having to influence M&A and to what extent perhaps U.S. elections here in 2020 might be affecting deal-making. Davina, what do you think about that?

Davina Garrod: So, historically, Jose, M&A has been sluggish, as we know, in a U.S. election year, given markets not liking uncertainty. However, I think digital transformation, increased activist activity, low interest rates and the tremendous amounts of dry powder sitting in the alternative investment space in particular, will counter election cycle madness. And if Trump is reelected, this will bode well for deal flow.

Gavin Weir: I agree with that, Davina. I think we're living through a remarkable cycle of dealmaking, and, in the last year, there was a 10 percent increase in the volume of deals being done in the U.S. in circumstances where, around the rest of the world, deal activity was down. What's driving that, I think, is a combination of very, very business-friendly government in the U.S., the corporation tax cuts, and we've had 10 years of ongoing growth. Some people are beginning to ask, when is that going to end? People have been asking the same question for the last five years, and, I think, with a Trump reelection, if that happens, I think he'll try his very best to use the levers of government or policy to try and continue to be business friendly, and that will only bode well for M&A activity.

Some people are beginning to say, well, is that necessarily a good thing?, and whisper it quietly, but even M&A advisors at some stage think, is it boiling up a bit too much? Especially with all the trillions of dollars that you've mentioned, Davina, of dry powder out there waiting for deployment. But that said, I think that goes to the question of deal values and whether deals are too expensive. That's not really the topic of what we are here to discuss today, but I think as long as there's money to spend and as long as there's a benign environment to spend it, I think people will continue to do deals.

I think the other factor that we need to bear in mind in the U.S. is the possibility of Trump not winning the election, and none of us are crystal ball gazers if you like, but, obviously, the opinion polls are moving around a lot.

And, so, one question people are asking is, what happens if Trump doesn't win, and if he doesn't win, who's it going to be and how will that affect M&A? I think, personally, if Joe Biden wins, he's the candidate that most people are saying his policies are less likely than others to have a major impact on M&A. That he's more centrist than the other candidates.

Having said that, I think an Elizabeth Warren victory or a Bernie Sanders victory really will make people sit up and listen. I think Elizabeth Warren, in particular, has indicated that she has some policies which are not at all friendly towards private equity investors in particular, some ideas about taxing portfolio companies and taxing private equity fees.

And I think for that reason if it looks likely during the course of this year there's going to be a Warren presidency or even if she's on the ballot paper post the Democrat decision on who's going to be the candidate, then I think that might cause a little bit of pause amongst some investors. That said, I go back to my earlier comments. My view is, I think people take a much, much longer-term view on M&A than one single election cycle. Whatever happens, there might be a slight uptick or a slight downtick, but if an M&A deal is worth doing, people are just going to do it anyway.

Jose Garriga: Thank you. One other factor that I think has to be considered is the question of M&A deal flow to and from China in light of a variety of factors that have all made headlines in recent months, including the PRC's economic situation, most recently coronavirus and certainly the ongoing unrest in Hong Kong. Gavin, what impact do you think that's going to have?

Gavin Weir: I think it could have quite a big impact, to be honest. I think if you'd asked me the question four weeks ago before the coronavirus evolved, I would have said maybe a minimal impact. One thing to bear in mind is, if you look at all the statistics from the last 10 years, there was a very, very, very dramatic increase in Chinese M&A into Europe and into the USA. That seemed to peak around 2016, 2017, and, over the last three years, we've seen a downturn—as much as 50 percent downturn—in volumes of inbound deals to Europe from China in the last three years. So, you're talking about coming off a relatively low base. Absent these events of this year, I would have been predicting a little bit of an uptick in China M&A and to Europe and the U.S. at least.

And having said that, I think a combination now of the coronavirus; the China economic downturn, as we noted before; Davina made some comments earlier about the scrutiny that many of these deals are getting from the EU and the U.S. authorities; trade wars; and now you add into that the coronavirus, where people literally can't even get on a plane to negotiate deals, I think that has to have an impact, and how much is anyone's guess.

One anecdote that we would give: We were speaking to a client a few days ago on this, that even down to practical things like the inability, for example, to get staffers in the Chinese regulatory bodies to actually get to work and approve deals that are already in the pipeline. So, it could have an effect on people's long stop dates for their SBAs, it might have an impact on timetables, et cetera, is leading to a lot of uncertainty. And, I think, in that environment, I don't see any other outcome than some form of downturn in Chinese M&A, and the only question is not whether there's a downturn—it's how dramatic it is.

Davina Garrod: Absolutely, Gavin. And as it applies to outbound Chinese investments, particularly into the U.S., I mean, since Trump assumed president, it's been very, very difficult to get any kind of Chinese investment into the U.S.

The Committee on Foreign Investment in the U.S. has opposed Chinese investments the last three or four years and even before that too. And even minority Chinese investments in European companies like the Portuguese energy incumbent EDP have been affected by CFIUS. Had China's Three Gorges acquisition progressed, EDP would have needed to divest its U.S. renewables business, for example. And notwithstanding Xi Jinping and Trump's signing of the Phase One trade deal, we still need to advise fund clients linked with Chinese money to ensure that the Chinese investment is made as passively as possible without Chinese control of the GP or the LPAC.

And this is in strong contrast, for example, to the U.K. position, where the CMA [*Competition and Markets Authority*] and U.K. government have approved all Chinese investments in recent years from Gardner Aerospace and Sepura/Hytera to Shagang Group and Global Switch. And Boris Johnson's even greenlit Huawei's investments in the noncore elements of U.K.'s 5G network, much to the chagrin of Donald Trump.

Switching to inbound investment into China, there's no doubt that coronavirus has made for a dismal Lunar New Year in China for sure, and deal flow into China has been disrupted due to factory shutdowns and travel restrictions. Reportedly, Tesla's factory and others are due to restart production, but our Beijing colleagues are warning that the entire industry supply chain is still affected.

And while staff at government agencies and state-owned enterprises are officially back to work, approving foreign investments is not a priority, unsurprisingly. Meanwhile, China-based employees at multinationals are working from home and dealing with chronic food shortages. I do think it's easy to overdramatize the situation, though. We need to remember that SARS was contained and did very limited damage to the global economy, unlike the 1918 Spanish flu, which infected more than a quarter of the human population of the world.

Gavin Weir: It's interesting, your thoughts there, Davina, because I agree with you. I think we shouldn't overdramatize it because it's still relatively early days. I think the biggest concern is the shutdown, effectively, of the country from overseas and internal travel, which, I think, will have a practical impact on dealmaking. I wonder whether, in light of all of this, the irony of the situation is, in the aftermath, might the Chinese authorities decide that they have to attract more inbound investments than they otherwise would have done because they need to show that China is open for business? And they were already making moves in that direction by allowing more foreign ownership of private companies where, historically, there was a limit on the stake that foreigners could own in Chinese companies. That had been removed, anyway, in some situations, in some circumstances. Query: Is that indicating more openness from the Chinese government anyway and might they extend that in the aftermath of this year's emergency, if you want to call it that?

I think the other factor to deal with here is, don't underestimate the long-term psychological impact of what's happening in Hong Kong to investors in China and people doing business with people in China. Again, we don't want to overdramatize it, but query: Might the situation there in Hong Kong combined with coronavirus and other things lead people to look in other directions, for example, Singapore, New York and such like? Without wishing to go back too much towards Brexit, a lot of commentators are saying that, actually, the great winners from Brexit are not going to be other European cities—the biggest winners from Brexit potentially are going to be New York, Singapore and possibly Hong Kong.

But I just wonder whether, in light of all of this, might there be a possibility that actually it's just Singapore and New York? That said, Hong Kong is remarkably resilient and will take a longer-term view. So, I think if anyone is going to turn this situation around, I would say the people of Hong Kong will do that, and, as many people say, from adversity comes opportunity. And I would equally say that there could well be many opportunities to invest in Hong Kong and, indeed, in China after this because, as I mentioned earlier on, coming from a relatively low base over the last few years where there has been a bit of a downturn of M&A activity in Hong Kong and China, this might be a good opportunity to invest at the bottom of the market if that's what it is.

Davina Garrod: That's absolutely right, Gavin. I mean, never underestimate the ingenuity and resourcefulness of the Chinese and, in particular, the Hong Kong Chinese. And, indeed, the Chinese ambassador to the U.K. was speaking over the weekend, and he made the point that, in Chinese, the word “crisis” means “crisis” and also “opportunity.”

Jose Garriga: Thank you, Davina. A reminder, listeners we're here today with Akin Gump international competition and trade partner Davina Garrod and corporate partner Gavin Weir discussing the outlook for M&A in the U.K., Europe and beyond.

Alright, so let's turn now, having discussed a variety of the issues in the U.K. and Europe and also worldwide that could have an impact on M&A, to what I guess we can call “news you can use” for listeners particularly. Let's start off with a question that I'm sure a lot of people have: What sectors are hot right now? And then which opportunities may be around the corner concerning M&A? Gavin, if you would, please.

Gavin Weir: Thanks, Jose. I think it wouldn't surprise anyone to know that the hottest sector remains the tech sector and has been for a number of years for obvious reasons. I don't see that changing at all. That said, I think the mix, if you like, within the tech sector is so broad that, arguably, “tech sector” covers almost any industry nowadays, and we need to move on from that and come up with some subsectors. But I think anything involving data, in particular, is going to be very, very hot. I think, for example, health care, historically, has always been a big sector, but, particularly, health care data is increasingly popular as is things like medtech, and I think that will provide M&A opportunities for health care companies. It also provides opportunities for tech companies themselves, and we've seen many examples of tech companies creating devices, which, on the face of it, are consumer devices like watches or phones, et cetera. But, actually, they contain technology which actually helps you with your health and produces data that you and the company can use. So, I think data's the big one.

Other areas: energy, renewables, as some parts of the energy sector become less and less popular because of climate change and social policy, et cetera. That produces, obviously, opportunities in other areas like renewables, and I think we'll definitely see a lot more opportunities in the renewable space and anything that connects renewables to technology.

Also financial services. I think that has always been up there in the top five sectors for M&A. I think that will continue to be the case. Interestingly, if you look at the statistics for China M&A over the last 10 years or so, there's been an enormous rise in the number of financial services deals done by Chinese buyers both within China, but also externally as well. So I think you'll definitely see financial services and, in particular, payments and fintech in big areas over the next year or two.

The other big one is on ESG [*environmental, social and governance*] where I think social change, views towards the climate, et cetera, that's got to be a factor in M&A decisions going forward. I can't believe that any large organization or investor is not going to take that into account. It might not necessarily be a driver for an M&A deal, but it's definitely going to be a factor for doing an M&A deal.

Davina Garrod: No, absolutely. And in terms of a couple of other sectors, too, that have been popular over the last year or two, real estate and also aerospace and defense. And just to pick up on Gavin's points regarding data and life sciences, M&A activity globally in life sciences exceeded an unprecedented $357 billion last year, breaking the 2014 record. And that's partly down to four mega-mergers: the AbbVie/Allergan, Bristol-Myers/Celgene, Danaher/GE Healthcare and Pfizer/Mylan. The forces driving this activity will continue, I think, to push deals in 2020, as companies optimize portfolios to deepen therapeutic area focus, seek to increase near-term revenue and use novel deal structures to access innovation.

Jose Garriga: Thank you, Davina. And let's stay with you. Based on this preceding presentation by both you and Gavin, what are your predictions then for M&A in 2020 and 2021?

Davina Garrod: I'm very bullish on European M&A activity throughout 2020 and into 2021, given the greater political stability in key markets; low-cost capital; a significant amount of undervalued assets, particularly in the U.K.; and all that private equity cash desperate to be put to work.

Gavin Weir: I would agree with that. I think I'm relatively bullish on European M&A, but I think particularly bullish on U.K. M&A. I think, Jose, the U.S.A. remains strong and will be strong despite election fever. I think Asia is inevitable, with the Chinese influence, I think, will probably be down but remains to be seen what happens across the rest of Asia.

And then, predictions for sectors, as I mentioned before, I think anything data-related is going to be hot. I think ESG will be a big factor, and I think the other thing we've not touched on yet, but I think is increasingly a factor in Europe is the increase in activist-driven M&A. It might not be the major factor in a corporate board doing an M&A deal, but I think the activists are increasingly influential either overtly when there's sort of a public campaign. But actually what we're hearing is that there's a lot of stuff going on behind the scenes as well with the traditional activists, and they're well known in the market, but also with some private investors who are maybe less well known but who are agitating on the boards. And I think lots of company directors I speak to are saying that they're increasingly mindful of that. And, in fairness, I think they're also saying that they, in some cases, welcome it because they realize that actually getting views from major shareholders and the outside world in a constructive way is very welcome.

Davina Garrod: Absolutely. And some of more institutional asset manager-type clients are becoming increasingly constructivist and suggestivist in their activities in this area. And, conversely, some of the more activist-type funds are spreading their strategy, keeping with the activism but also moving more into private equity as well. So, we're seeing a number of role shifts and a more amorphous approach to investment strategies.

Jose Garriga: Thank you both. So just to wrap up, the question I'm sure listeners will be having is what short-term takeaways can you offer them regarding, people, they're looking to make deals this year, what do they need to know?

Davina Garrod: I mean, as we've said, there's a lot of undervalued opportunities in Europe and in particular in the U.K. with relatively light regulatory scrutiny over here in the U.K. as well, unless you're looking to acquire your major competitor in a concentrated market, that is, in which case, the U.K. CMA will be investigating you in depth. In terms of other key takeaways, preparation and timing are key, consult your lawyers early, and remember that the proposed U.K. FDI regime isn't due to kick in before 2021, and the U.K. is very much open for business.

Gavin Weir: I agree, Davina. I think I mentioned before elections, sanctions, trade wars and such, they make for good press, but, in many cases, they don't stop M&A deals being done. So, I think my takeaway is, yes, deals will be done, process might be a bit more complex, a bit more time-consuming, but if you plan early, consider your strategy to navigate around these issues, then you're more likely to have a good outcome. Bottom line is: Be patient.

Davina Garrod: Everything comes to he or she who waits.

Jose Garriga: Listeners, you've been listening to Akin Gump international competition and trade partner Davina Garrod and corporate partner Gavin Weir. Thank you both for appearing on the show today and taking our listeners on this terrific *tour de horizon* of the M&A landscape.

And thank you, listeners, as always, for your time and attention. Please make sure to subscribe to *OnAir with Akin Gump* at your favorite podcast provider to ensure you do not miss an episode. We're on, among others, iTunes, SoundCloud and Spotify.

To find out more about the firm's thinking on European M&A, look for the publication *Open for Business* on akingump.com. And then to learn more about Akin Gump and the firm's work in, and thinking on, corporate, antitrust and trade matters, look for "international trade," "antitrust" and "corporate" on the Experience or Insights & News sections on akingump.com and take a moment to read Davina's and Gavin's bio's on akingump.com.

Until next time.