

An excerpt from
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M&A Market sweetens, but do wrinkles remain?

Following the passage of the new US tax bill, optimism about 2018 M&A abounds. "People were waiting for the smoke to clear," says Peter Hawthorne, VP Corporate Strategy and Development at Cargill. "For both onshore and offshore investors, it provides clarity."

"US Companies can now bring cash back home, so I would expect an inflow of repatriated corporate cash to fund domestic M&A," agrees Jonathan Rothenberg, SVP Corporate Development and M&A at GlobalLogic. "It's been ten years since we've had as good a regulatory environment to invest, plan and do business in."

One trend to watch for is a convergence between industries, says Kimberly Petillo-Décossard, who leads the M&A practice at Cahill Gordon & Reindel, pointing to Amazon's acquisition of Whole Foods as an example. "For the bigger transactions, I think you'll continue to see companies strike cross-sector deals, while in the mid-market, expect further consolidation within industries."

Despite the optimism, industry experts pointed to potential valuation and regulatory headwinds that could impact 2018 activity.

Skyrocketing Valuations

Robust equity markets and cheap debt have ramped up acquisition prices. "If multiples remain where they are, I think valuation is the biggest risk we face as we think about 2018," says Stephen Vather, Executive Director, Corporate Development and M&A at ManTech International.

Last year's valuations were incredibly high and made for expensive deal-making, agrees Petillo-Décossard. The competition remained so fierce some buyers opted out or were shut out, despite having plenty of money on hand. "We'll have to see how high valuations can go before deals break."

But high prices may be here to stay, Hawthorne says. "In the current rate environment, I think people are coming to the view that we have to live with valuations for the foreseeable future."

One result of high valuations will be a continuing shift to alternative deal structures. While the capital markets are hot, expect companies to look to IPOs to maximize value. In biotech, there also will be an increase in JVs, licensing and other collaboration agreements, Petillo-Décossard says.

Regulatory Uncertainty

The Department of Justice's move late last year to block AT&T's merger with Time Warner on vertical antitrust grounds surprised many in the industry expecting light enforcement under the new administration.

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Although there has been speculation that the DOJ's suit against AT&T's merger with Time Warner is related to political hot potato CNN, it more likely reflects a broader policy change, according to Elai Katz, antitrust partner at Cahill Gordon & Reindel. "The new antitrust leadership wants to avoid regulation as much as possible, but they care deeply about enforcing the law as they understand it."

As a result, there may be a more binary approach to antitrust deal approval in coming years, Katz says. Vertical mergers that historically might have been solved with behavioral remedies or settlements may be treated differently as the DOJ seeks to avoid ongoing regulatory oversight.

"To the extent people thought this was going to be a free-for-all, disabuse yourselves of that notion," says Katz. "People should start from the premise that this antitrust division is not going to be all that different from prior administrations."

Even for those who believe the AT&T move is an outlier, the US DOJ is only one piece of a larger global puzzle. As the global economy matures there are far more countries with active antitrust programs. "It's just a fact of life," says Hawthorne.

The European Competition Commission has become increasingly focused on the merger's impact on innovation and R&D, and China's merger control authority, MOFCOM, continues to provide challenges from a merger timing perspective, says Joel Grosberg, antitrust partner at McDermott Will & Emery. "The most important thing is to ensure counsel is coordinating on the arguments, strategy and process so you have consistent arguments among the regulators."

In addition to the court ruling on the DOJ's suit against AT&T and Time Warner, a key question for next year is if and how the Federal Trade Commission's approach will differ from the DOJ, according to Katz. "They are still in a transformative period, but a recent speech suggests the FTC may not disagree with the DOJ on vertical mergers."