Slow but steady: US M&A H1 2016

Despite a slower first half, the underlying drivers of M&A activity remain strong.
The frenzied pace of US M&A in 2014 and 2015 calmed in the first half of 2016, returning the market to far more sustainable and familiar activity levels.

After two blockbuster years, the first half of 2016 has brought M&A activity back to normal levels of activity, with fewer megadeals and generally lower deal values. Although deal flow is lower than last year, H1 2016 is in line with historically strong M&A trends. The 2,291 deals recorded in the first six months are far ahead of the 1,825 deals recorded in H1 2013.

Economically, US GDP growth is slightly below last year’s 2.4 percent increase, and there is the specter of rising interest rates on the horizon. Europe’s markets are sluggish, questions continue as to the pace of China’s economic growth and oil prices remain low. But, overall, the appetite is still in place and the broader macroeconomic backdrop is amenable for deals.

Regulatory issues have arisen in connection with certain transactions. The Committee on Foreign Investment in the United States (CFIUS), which reviews transactions that could result in control of a US business by a foreign person, blocked the sale of a Dutch company’s US-based lighting division on national security grounds. And several deals are facing tough challenges under the US government on antitrust grounds.

Politically, it’s been a particularly challenging year, from the ongoing drama of the US presidential elections to Brexit. The uncertainty resulting from the latter in particular will no doubt resonate for years to come. While it is difficult to speculate on actual outcomes until negotiations begin, the stakes are high for US M&A, given the UK’s position as the top target for US buyers, with 128 deals worth US$20.8 billion.

Yet, despite all of this uncertainty, there are reasons for optimism. The technology, media and telecommunications (TMT) sector continues to dominate deal flow, accounting for 22 percent of all transactions, as executives and dealmakers acknowledge the transformative opportunities presented by tech. Non-tech buyers are also keeping an eye on the nascent fintech industry. And the pharma, medical and biotech sector (PMB) saw 250 deals, accounting for 11 percent of deals—including the first half’s two biggest single takeovers: Ireland-registered Shire bought Baxalta at the start of the year, and Abbot Laboratories acquired St. Jude Medical in April.

Sectors like TMT will no doubt continue to offer new opportunities, even if the wider geopolitical and macroeconomic picture causes some to look very closely before they leap. More broadly, the conditions that have driven M&A around the world for the past two years have not fundamentally changed and so we expect a very busy second half.
Slow but steady sets the pace

After a somewhat slow start to the year, US M&A deal values were given a major boost in mid-June 2016 when Microsoft announced its largest-ever acquisition: a US$26.2 billion bid for professional social network LinkedIn. This was notable not only for the size of the deal but also because it was one of so few this year—megadeals have been thin on the ground in 2016. The largest H1 deal—pharmaceutical maker Shire’s US$35.2 billion takeover of Baxalta—was the only one on a scale similar to the large transactions seen in H1 2015, such as Anthem’s US$54.2 billion agreement to acquire Cigna, and Charter and Time Warner’s US$55 billion deal.

Overall US M&A deal volume was down 11 percent year-on-year, from 2,585 in H1 2015 to 2,291 in H1 2016, according to Mergermarket figures. Aggregate deal value was down 30 percent, from US$822 billion in H1 2015 to US$577.2 billion in H1 2016.

This comes against a backdrop of moderate economic growth, with the World Bank expecting the US economy to grow by 1.9 percent this year (compared to 2.4 percent in 2015), slow employment growth at mid-year and the political uncertainty of an election year, as well as the Brexit vote and its aftermath.

Inbound US M&A volumes began the year by bucking global trends. While inbound activity was treading water elsewhere in the world, the number of US companies bought by foreign firms in the first quarter of 2016 stood at 224, compared with 197 in Q1 2015.

That pace held firm for the remainder of the first half of the year, with inbound M&A reaching 448 deals, up from 420 deals in H1 2015. Inbound deal value in H1 2016 was subdued, however, at US$169.3 billion, compared with US$194.6 billion in H1 2015.

Strategic thinking
According to John Reiss, global head of M&A at White & Case, this is all just strategic M&A in action: “We were incredibly busy in the first half of 2016, even if that seems contrary to what the data suggests,” says Reiss. “While we’ve seen value and volume down this year compared to 2014 and 2015, if you take it from post-crisis years, it’s fairly standard.”

Regulatory headwinds have put a halt to some larger deals. The collapse of the US$160 billion Pfizer-Allergan merger, amid a crackdown on so-called tax inversion deals, was one of the most high-profile casualties of this broader trend. Others that fell by the wayside included a proposed US$34 billion acquisition of oilfield services group Baker Hughes by its rival Halliburton, blocked by the US Department of Justice on competition grounds in April. And CFIUS blocked Asian investors from acquiring a Dutch company’s US-based lighting division on national security grounds.

But there are other factors at play, according to Reiss. Some buyers are choosing to take a breather during the approvals process, rather than sustain the hectic pace of M&A witnessed in 2014 and 2015.

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Top ten US M&A deals, H1 2016

<table>
<thead>
<tr>
<th>Announced date</th>
<th>Completed date</th>
<th>Target company</th>
<th>Target dominant sector</th>
<th>Bidder company</th>
<th>Bidder dominant country</th>
<th>Deal value US$ (m)</th>
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<tr>
<td>11/01/2016</td>
<td>03/06/2016</td>
<td>Baxalta Inc.</td>
<td>Medical: Pharmaceuticals</td>
<td>Shire Plc</td>
<td>Ireland (Republic)</td>
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<td>13/06/2016</td>
<td>Forte Corporation</td>
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<td>Danaher Corporation (Shareholders)</td>
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<td>Services (other)</td>
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<td>02/05/2016</td>
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<td>Fortis Inc.</td>
<td>Canada</td>
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Top 10 inbound bidders by deal value, H1 2016
Slow but steady: US M&A H1 2016

Top outbound targets by value, H1 2016

“Some of these big deals take a very long time to approve. You’re not going to be doing much in the interim. And after a really lengthy approval period, you need to digest the results—all in the context of an unprecedented, inflammatory, divisive and uncertain election process,” he says.

That sense of greater uncertainty is prompting some hesitation in dealmaking. “In general, people are viewing this year as more unsettled than last, and there is a sense that deal activity is being somewhat affected because of that,” says Mort Pierce, a partner at White & Case.

While the Shire-Baxalta megadeal is largely about the entities becoming bigger and more significant in terms of the marketplace, most recent deals have been of a much smaller scale. “If a larger merger makes sense, they will still pursue it, but the bulk of the activity is larger companies looking at smaller companies, wanting to fill the gaps in products and markets they don’t currently have,” says Pierce.

In and out

Inbound deals in H1 were dominated by Canadian acquirers, such as Fortis snapping up ITC Holdings for US$11.3 billion, an energy sector transaction. Total Canadian inbound deal values reached US$50.6 billion, with 73 separate deals.

Inbound Asia deals remain a key part of the story, with China ranking

Top outbound targets by value, H1 2016

- United Kingdom
- Ireland (Republic)
- France
- Canada
- Italy
- Taiwan
- Germany
- India
- Netherlands
- Denmark
Shareholder activism in 2016

Shareholder activism has become a major talking point in America’s boardrooms in the past few years. It has been a driver for M&A and has spread beyond its hedge fund origins—even institutional investors now have activist agendas.

For example, four directors from activist fund Starboard Value were added to Yahoo!’s board in April 2016, while United Continental appointed two new board members in the same month to pacify agitated activists PAR Capital and Altimeter Capital Management.

Board engagement with shareholder activists is ensuring better dialogue in some cases, with a more constructive approach resulting in win-win situations—but win-win is often in the eye of the beholder.

“In the US, if you’re an activist, you’re not necessarily trying to get majority control of a board, you’re just looking for a couple of seats. And in all likelihood, you’re going to win them because of the growing influence of proxy advisory services, which will typically recommend a vote in favor of this sort of move,” says Pierce at White & Case.

“Boards realize they are likely to lose these contested elections, so they usually settle to avoid the expense of the contest and the loss of management focus on the business. They are not surrendering a majority of the board, just one or two seats. But this change in board composition can have significant influence on the board’s decisions in the future.”

It’s too early to say where shareholder activism will take US M&A at the moment, but their influence is certainly being felt. And as their influence rises, activists are facing their own challenges. The US Department of Justice, for example, has recently filed a suit against ValueAct over its possible failure to comply with the Hart-Scott-Rodino Act.

However, once shareholders are on the board, they can often rally their cause and push board members in unexpected directions.

Sectors in brief

TMT dominated sector-specific US M&A deal volumes for the first half of 2016—with innovative technology galvanizing buyer interest.

TMT’s continued strength and its convergence across other sectors is good news for the M&A market, and, as White & Case’s Reiss points out: “Success breeds success.”

M&A in the fast-growing tech sector, he argues, has proven resilient despite the risk factors breeding uncertainty in deal markets. Fluctuations in equity markets and the increasing difficulty in obtaining debt do not seem to have affected global tech sector M&A to any great extent in 2016.

Technology will affect a broader range of industries, even the more
Companies from Asia are getting more comfortable with the US environment and processes, with how to come in and buy a company in the US.

John Reiss, Global Head of M&A, White & Case
Once again, TMT tops the industry-specific M&A volume table as investor hunger for opportunities in tech continues to grow. In the first half of 2016, the sector saw 495 deals, well ahead of the next highest, Industrials & Chemicals, in which 372 transactions were made.

The latter was characterized by a particular interest in petrochemicals, particularly with regards to agriculture, continuing a trend that began in 2015 with the US$130 billion merger of Dow Chemical and rival DuPont, and Bayer’s ongoing interest in US agribusiness Monsanto.

A healthy future for M&A?
Headline-grabbing moves in other sectors include the US$35.2 billion megadeal that saw Ireland’s Shire PLC acquire Baxalta in January, followed by Abbot Laboratories’ acquisition of St. Jude Medical in late April for nearly US$30 billion. Those two deals, worth more than US$65 billion, account for 56 percent of the total PMB deal value for H1 2016. Alone, they amounted to more than half of the US$88 billion accrued by the other eight M&A deals in the top ten, underlining the impact of the PMB sector on deal values in H1 2016, despite the sector only being fourth in terms of volume at 250.

Given the recent innovations in healthcare technology, from mobile x-rays to long-distance diagnosis, the TMT and PMB sectors may be on course for convergence through M&A in coming years. However, according to White & Case partner William Choe, strategic partnerships or investments coupled with partnership agreements between companies are sometimes more attractive than M&A.

Choe cites the example of a medical devices producer creating implants that can collect a patient’s medical data. “The data is stored in the cloud and examined with big data analytics software to provide insights for patient diagnosis and therapeutics,” he says. “Under these circumstances, a medical devices business might find it more practical to enter into commercial arrangements with cloud services and data analytics companies, rather than acquiring them. The evolution and integration of advanced technologies could drive or hinder M&A activity in different scenarios.”

Power moves
The energy, mining and utilities (EMU) sector features in the top...
Tax inversions

A staple of some large cross-border transactions over the past few years, tax inversions typically involve a company that is subject to the US tax system on worldwide income and that is attempting to re-domicile in a foreign jurisdiction with lower tax rates.

However, there has been an increasing public and political backlash over such deals. In April 2016, the US Treasury announced new measures to clamp down on inversions, making it difficult for companies to move tax addresses out of the US and then shift their profits to lower-tax domains.

"Under the existing rules, an inversion generally gets triggered when the shareholders of the US entity own 60 percent or more of the new foreign parent," says Andrew Kreisberg, a partner at White & Case. "The new rules have made it easier to cross this threshold test by, in effect, increasing the size of the US entity and decreasing the size of the foreign entity in certain situations. As a result, shares of the new foreign parent that are issued to US shareholders are deemed to constitute a larger percentage of the new foreign parent."

Does that mean tax inversions are off the agenda? Not necessarily. Smaller inversions may still be possible.

"Some of the bigger deals might go away, but inversions are not gone for good" says Kreisberg. "It will be interesting to see what effect the new earnings stripping rules have on the frequency of inversions."

The other sizeable power sector

Alternatively, hybrid restructuring-related M&A could step up, with creditors simply taking over the keys to these companies through the restructuring process.

"For the first half of 2016, oil and gas businesses have been more focused on distressed M&A and restructuring-related M&A," says Pryor. "That’s the real story."

Tech still taking hold

While only one of the top 10 deals in H1 was technology focused, it is still very much at the fore across the board. Dealmakers still have an appetite for tech as it relates to healthcare, big data analytics and machine learning, fintech, cloud services, data security and the Internet of Things. The difference now, after the large consolidations of 2015, is that buyers seem more interested in mid-size or smaller deals, according to Choe.

As he points out, a slowdown following the tech M&A boom of 2015 is hardly surprising, as buyers reorganize their post-deal operations. However, the number of mid-size deals has been climbing in 2016, suggesting that the slowdown may be more a question of deal size than volume.

An exception to the trend is Microsoft’s US$26 billion takeover of LinkedIn, announced in June 2016, one of the largest deals of the year so far in any sector. "While we have seen decreases in the total value of tech-driven US M&A in 2016, the number of deals has remained pretty stable. The megadeals that characterized this space in 2015 may not resurface during the course of this year, but the overall tech deal flow does not seem to be slackening," says Choe.

Broader emerging technology megatrends are playing a part in this process, creating new M&A demand for companies that produce enabling technologies, such as the ASIC chips that allow for machine learning. The tech M&A market comprises a complex array of integrated sub-sectors, and smaller specialized companies within these sub-sectors may prove to be very attractive.

Finally, convergence will continue to push US M&A in years to come as non-tech companies become increasingly active in the tech M&A market.

"Universal connectivity, the social web, big data, the cloud and, most importantly, blockchain—these have all created the perfect environment for smaller startups to be noticed," says Hahn.

"Larger companies need to decide if they want to take the time and money to build new technology offerings themselves or if they need to buy them in order to jumpstart—or just keep up with— the competition."
Fintech: revolution and regulation

HEADLINES
- Venture capital funding in the US fintech sector during Q1 2016 increased 70 percent over the previous quarter, to US$1.7 billion
- 47 percent of all fintech M&A in 2015 related to payments systems
- The evolving regulatory landscape and past fintech performance will likely have an impact on current and future M&A activity

Technology has been encroaching into financial services territory for more than half a century—from ATMs in the 1960s to the introduction of electronic market trading in the early 1980s. However, interest in companies that propagate technological innovation in the industry has boomed in the past few years, throwing fintech into the mainstream.

Last year, a number of fintech deals shook up assumptions about how financial services work. These included deals such as exchange and marketplace operator ICE acquiring financial data vendor IDC from private equity firms Silver Lake Group and Warburg Pincus for US$5.2 billion, and DH Corp’s decision to purchase financial software maker Fundtech for US$1.25 billion. Away from billion-dollar acquisitions, early-stage investors are also increasingly looking to provide seed capital to exciting new fintech opportunities.

In Q1 2016 for instance, overall venture capital (VC) funding in the US fintech sector increased 70 percent compared to the previous quarter, reaching US$1.7 billion, according to a report on fintech VC trends published by KPMG and CB Insights. Fintech deals are not just limited to incumbent industries or VCs, either. Large financial institutions are also buying out startups rather than just purchasing minority stakes. For example, in August 2015, BlackRock, the world’s largest fund manager, acquired California-based “robo” advisory firm FutureAdviser for US$150 million.
In March 2016, Goldman Sachs’ Investment Management Division announced it would acquire digital retirement savings platform Honest Dollar for an undisclosed sum. And in April, US financial services firm Ally Financial acquired digital wealth management company TradeKing Group for US$275 million.

“There are tremendous opportunities establishing themselves,” says White & Case partner Kevin Petrasic. “We will see significant transactional activity involving various entities, some of whom may have great funding while others have insufficient funding, or they may have a lot of money but not necessarily a great idea, or vice versa.”

Payment’s progress
Fintech has the potential to completely transform the financial services industry across the entire supply chain, from the consumer-facing aspect of handling transactions to the nuts and bolts of accounting practices. Focusing on the former, the payments segment of fintech has seen an astonishing rise. According to data provider Pivotl, 47 percent of all fintech M&A last year related to payments systems—and with good reason. Financial information firm Markit forecasts that the total value of mobile payment transactions will rise by 210 percent to US$27.05 billion in 2016, up from US$8.71 billion in 2015.

In Petrasic’s view, the payments sector may help “socialize” the transactional M&A experience, simply because it is far more familiar with this kind of technology. “Payments has been on the cutting edge of technology in financial services for some time, and in many respects, it continues to lead the way in fintech,” says Petrasic. “The segment has been besieged with interest from players in a wide variety of sectors, from banks to tech and telecoms companies. The companies that develop the best tech-based solutions could lock in a huge competitive advantage.”

Established firms are looking far and wide to lock up this edge as well. For instance, in July, MasterCard invested an undisclosed sum in India-based online payment gateway solution Razorpay.

As well as affecting subsectors, fintech is also eschewing wider industry norms to shake up financial services. Banking, for example, has seen a host of startup companies launch in the past few years looking to lock horns with larger, more-established players by competing on consumer-sensitive issues such as fees.

In response, many larger institutions are looking to snap up these young competitors early on. Spanish banking giant BBVA, for instance, purchased American start-up Simple in 2014 for US$117 million, and added to its portfolio last year by buying a 29.5 percent stake in British digital-only lender Atom for £45 million.

New kids on the blockchain
While not as developed as the payments subsector, blockchain could enliven the fintech M&A market in the coming years. The technology has garnered interest because of the way it decentralizes the control of data—therefore making it more secure, drastically cheaper and faster by decreasing the transaction costs and eliminating intermediaries.

“There are so many different products and services that can be built using blockchain,” says Petrasic. “Kansas-based CBW Bank, for instance, has tremendous blockchain capabilities.”

Investment so far in blockchain has been small compared to the payments sector, but increased VC activity in the space points to brighter things in the near future. A KPMG/CB Insights report from March found that investment in bitcoin and blockchain rose from just US$3 million in 2011 to US$474 million in 2015.

While outright acquisitions in the blockchain space have been limited, major financial services players are still keen to keep abreast of its development. This is particularly

There are tremendous opportunities in fintech M&A establishing themselves. We will see significant transactional activity involving various entities.

Kevin Petrasic, Partner, White & Case
noticeable among both US and foreign banks, which are exploring the technology’s potential with tremendous interest. In September of last year, for example, nine of the world’s largest banks—including Goldman Sachs, J.P. Morgan, Barclays and UBS—joined forces with fintech firm R3 with the goal of creating a framework for using blockchain technology in the markets. “Banks that are multiple sizes larger than CBW are cautiously exploring blockchain,” says Petrasic. “But they’re all at different points along the learning curve, with many still far from any actual implementation.”

Whose rules?

While the excitement surrounding the investment and M&A potential in fintech is understandable, several factors have caused consternation among would-be investors.

For example, while these breakthroughs offer a wealth of opportunities, companies have to be mindful of the regulatory implications, as governmental agencies play catch-up with each new development. In March, for example, the Office of the Comptroller of the Currency in the US issued a white paper to launch formal discussions between regulators and fintech industry leaders. And while Republican Congressmen and women are looking to promote a legislative package covering fintech called “Innovation Initiative”, laws specifically covering modern financial services technology are still in their infancy.

“A challenge for regulators is that they have to make sure that the day-to-day is taken care of while looking ahead to address new developments,” says Petrasic. “That includes considering ways that regulations may need to be adjusted to facilitate innovation but also to manage emerging issues related to cyber security and consumer protections.”

Another regulatory curiosity fintech investors should consider is that while fintech exists in somewhat of a regulatory vacuum, the financial services industry it is looking to capture is one of the most heavily regulated in the world. How this gap will be bridged has yet to be decided.

“Just in the banking context at the federal level, there is the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency—as well as various other offices of the Department of the Treasury—and the Consumer Financial Protection Bureau,” notes Petrasic. “There are also regulators in each of the states. All of these players have very important roles in regulating financial services companies, but their roles often overlap.”

False startup

Regulatory uncertainty may cloud the direction of fintech’s future. However, examples from the burgeoning industry’s past suggest that, rather than focusing on what legislation may do to hamper it, investors need to pay more attention to the viability of some areas of fintech.

One key representation of this is the once-vaunted marketplace lending sector, which accrued major interest in the past few years. However, recent developments and performance from some of its key companies have cast a shadow over its viability.

For instance, Lending Club stock plummeted in 2016 when its CEO resigned following an internal probe that found the company had knowingly mis-sold faulty loans to an investor. Elsewhere, marketplace lender Prosper cut ties with loan-referral websites LendingTree and Credit Karma in June, suggesting a slowdown in appetite for peer-to-peer loans. This came after the company’s loan volume fell by 12 percent in the first quarter of 2016.

Even more glamorous segments of fintech have seen companies struggle. Square, for example, one of the most high-profile fintech payments companies on the planet, saw its share price fall to US$9.27 by July 1 after opening in November at over US$13.

Over the next few years, fintech M&A is likely to proceed in a stop-and-start fashion, but, ultimately, it is likely to be a source of significant activity that could reshape both the retail and corporate segments of the financial sector.
US M&A in figures


![Graph showing total US M&A from H1 2011 to H1 2016]

TMT, industrials and business services poised to be most active in 2016


![Diagram showing sector deal flow in 2016]

Inbound M&A by country, H1 2016

- **Sweden**: 18 deals, US$2.8 billion
- **Switzerland**: 23 deals, US$0.6 billion
- **Germany**: 23 deals, US$12.3 billion
- **France**: 30 deals, US$0.8 billion
- **Canada**: 73 deals, US$50.6 billion

Outbound M&A by country, H1 2016

- **Netherlands**: 21 deals, US$20.8 billion
- **United Kingdom**: 128 deals, US$2.5 billion
- **India**: 25 deals, US$1.4 billion
- **Australia**: 23 deals, US$3.9 billion
- **France**: 21 deals, US$0.9 billion
- **Germany**: 34 deals, US$3.1 billion

1 Indicated by size, where the smallest is US$129 billion, and the largest is US$554 billion.

* The Intelligence Forecaster is based on “companies for sale” tracked by Mergermarket in the United States between January 1 and July 6, 2016. 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 2016.
Private equity deal activity was under pressure in the first half of the year, as the high yield debt market went into a tailspin and banks hesitated to support leveraged buyouts.

“For a good portion of the first and early second quarter, there was almost no debt available,” says Oliver Brahmst, a partner at White and Case. “As a consequence, the beginning of this year saw a pretty big drop in activity.”

The number of private equity buyouts declined 8.4 percent in H1 2016 year-on-year, though deal values increased slightly from US$62.8 billion to US$74.3 billion.

The decline in private equity exits was slightly less pronounced, with just 423 deals in the first half of 2016, compared with 448 during the same period in 2015. However, exit values dropped 11 percent to US$99.7 billion.

In terms of sectors, there is still appetite for PE deals in areas such as PMB and TMT. The biggest first-quarter exit involved computer services group Dell’s acquisition by NTT DATA Corp. for US$3.1 billion. In another large H1 2016 deal with a PE component, medical supplies maker Sage Products was sold in February by PE firm Madison Dearborn Partners to medical technology company Stryker Corp. for US$2.78 billion.

On the medical tech convergence side, US healthcare IT firm Truven Health Analytics was acquired by IBM in February for US$2.6 billion from New York–based private equity firm Veritas Capital, which bought Truven in 2012 for US$1.3 billion.

Demographics in the US support investment in healthcare. As a percentage of GDP, US citizens continue to spend more money on healthcare and drug development than most other countries, and PE firms are paying attention.

“These are very attractive deals to any investor, but private equity especially has got into the software and tech sectors in a big way in the past couple of years,” says Brahmst. “The reasons are fairly obvious—this approach gives them a good fallback, it’s scalable and there’s not much capital expenditure.”

**Tech talk**
The tech sector’s appeal in general is obvious, with the US remaining...
a global leader in the field. PE clients have determined a way for PE to play a role after a tech company leaves the venture capital space and before it chooses to go public. Rather than buying it in a private sale, private equity can take it to the next level.

For example, the biggest PE-linked deal in the first half of 2016—one of the largest leveraged buyouts in recent years—saw PE firm Apollo buy out home security systems manufacturer ADT and merge it with security specialist Protection 1, in a deal valued at US$15 billion, including debt.

"You’ll see more PE firms and hedge funds broadening their offering, and there’s certainly plenty of money out there that is getting invested in all levels of the capital structure, whether in healthy or distressed assets," says Brahmst.

He points out that many large PE firms have morphed into alternative-asset managers, owning distressed funds and diversifying across the capital structure.

"You need the strategy and you need the management team," he says. "Take software: It’s much cheaper than running an airline, there’s no capital expenditure and it’s extremely scalable."

A new way for PE deals?

Despite the slowdown in activity and the temporarily weaker debt markets, money continues to migrate into PE deals. Successful managers are figuring out how to make money not just by being leveraged. Debt is less pivotal to deal success these days.

"We have clients who just co-invest in minority stakes, and we have clients who invest more equity than debt because they understand how they can grow the company by increasing profits and maybe even increasing the multiples," says Brahmst. "They see valuation and multiples increases on the horizon both on an industry and company level."

A higher level of PE-backed M&A can be expected, reflecting a desire to find new ways to make deals work. Simply taking control of investments and leveraging the company with debt is proving less effective.

The large club deals that used to dominate in PE are unlikely to come back anytime soon, with less appetite to team up than before. However, a different form of club deal—described as "quasi club"—could be emerging.

"We are now involved in large transactions where the seller is going to roll over some of its equity into the new deal, so it becomes a club deal," says Brahmst. "There is a significant amount of equity, but the buyer recognizes it can’t write the entire equity check by itself, so it is prepared to roll over some of its investment. The seller, on the other hand, wants to take some money off the table, but it still wants to ride the upside.

"Some non-US funds that have only previously dipped their toes in the US market have done deals where the seller has rolled over, and that has given them some confidence. They become a team, with the roll-over seller bringing their historical expertise and knowledge of the company and the US domestic market into the boardroom."

"That gives, for example, a London-based PE buyer much more confidence that they can understand and be successful in the US market," says Brahmst.

While there remains challenges on the horizon, Brahmst argues, the outlook remains good: "From a personal perspective, I’m as busy as ever. Maybe that’s anecdotal, maybe I’m just lucky, but I’m seeing a lot of activity in a lot of different sectors."

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### Buyouts by sector

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<th>Sector</th>
<th>Deal value (US$ billion)</th>
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<td>Business Services</td>
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**US $6.5 billion**

The value of the biggest first-quarter exit—China-based Anbang Insurance Group’s purchase of Strategic Hotels & Resorts from Blackstone Group
Conclusion: politics, tech and plenty of capital
Following a record-breaking year, the US M&A market is taking time to digest recent deals, and uncertainty regarding broader macroeconomic and political issues is leading some to take a more cautious approach. Three broad factors are likely to influence activity for the remainder of 2016.

**Politics at play**
The political climate may lead many to proceed with caution. The UK’s Brexit decision ensures that economic uncertainty will continue in Europe, and the US presidential election in November may also cool the ardor for transactions. Stricter rules limiting tax inversions—a structure used for several pharma megadeals in recent years—may also give pause for thought.

**Tech deal traffic**
There are signs of more mid-size deals in the tech sector, with suggestions that the decrease in overall deal values is not reflective of the continued strength of this space. The number of actual deals has remained stable, and the economics for tech M&A remain viable. Moreover, the rapid pace of technological change can make it more practical for established tech companies to buy innovative start-ups rather than investing in their own R&D channels—a process that would be facilitated by many buyers’ cash-rich balance sheets.

**Money on the table**
There is certainly available capital should companies wish to pursue an M&A route. Firms are still buying stock, which indicates that they have the resources for transactions. But many of the more exciting opportunities, such as fintech, are in the early stages, which makes it difficult to anticipate any major moves.

**The rest of 2016**
As we go to print in late July, we see a noticeable slowdown in activity. We think the US M&A market is taking a short breather and will come back strongly in September, absent some big exogenous shock. Most of the conditions for a busy end of year remain in place: Lots of cash, low interest rates, strong stock markets (notwithstanding the elections and Brexit) and plenty of strategic imperatives in many industries that can best be satisfied through acquisitions.

**US elections: an exercise in uncertainty**

The febrile political atmosphere in US politics—particularly surrounding Donald Trump’s rise as the Republican nominee—has shifted political risk higher up the corporate agenda when it comes to gauging potential M&A decisions. Even in the early months of the presidential primaries, the political climate was already having an impact. New measures on tax inversions, introduced by the US Treasury Department in early April 2016, highlighted serious differences between the parties, notes William Dantzler, a partner at White & Case who specializes in tax issues. “Whereas the Democrats want to surgically cut out inversions and deal with the fact that our tax system is ‘out of whack’ with the rest of the world later, the Republicans want to use inversions as a hold-up opportunity to deal with the ‘out of whack’ tax system and so don’t want to do anything about inversions either tactically or surgically,” he says.

While inversions are still being talked about in the presidential campaigns, Dantzler does not believe it will be an ongoing concern. “There won’t be many future discussions about inversions, but you will hear people talking about American companies leaving America and taking jobs with them,” he says. “Both Hillary Clinton and Donald Trump have assailed that in their different styles.”

Another key consideration is the way the presidential candidates will deal with foreign ownership. In the past, Middle East and Chinese buyers have encountered opposition on national security grounds. Much of the focus will be on CFIUS. This inter-agency committee has a mandate to review inbound foreign direct investment where there is a merger, acquisition or takeover of a US business under which control effectively shifts to foreign ownership. However, the US electoral cycle does not necessarily impact CFIUS decisions. There is a view that a change of administration in January 2017 could shift the overall perception of foreign direct investment. The current campaign rhetoric suggests that there’s going to be more scrutiny. For many investors, the impetus is to get deals done now,” says Farhad Jalalious, a White & Case partner with extensive experience with CFIUS issues. “But in my experience, campaign rhetoric doesn’t necessarily hold up,” he adds. “Once any new administration has settled into office, there aren’t usually any material swings in the pendulum regarding threat vulnerability analysis.”

Bank lending is also on investors’ radar as the US presidential election approaches. New financing activity may settle down in the October to November timeframe as the market takes stock of the candidates, notes Eric Leicht, a White & Case partner who specializes in bank lending. At this point in the campaign, neither candidate has proposed anything that would seriously affect lenders’ appetite and willingness to support M&A deal flow. “Trump is viewed as pro-business, but Wall Street also craves stability and Trump is perceived as a wildcard by many,” says Leicht. “The general view is that a Clinton victory will be favorable for business, providing continued stability and an approach that should be the same or even more business-friendly than Obama’s.”
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