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Beware the disruptors

Herbert Smith Freehills' global head of M&A **Gavin Davies** and corporate partner **Caroline Rae** look at the themes that will dominate mergers and acquisitions in 2019

In 2018, global M&A values exceeded those in 2017 to reach one of their highest points since the financial crisis. This was in part buoyed by a number of mega deals, including the \$79.7 billion takeover of Shire by Takeda. Whilst there was a slowdown in pace during H2, deal activity recorded near peak levels in many markets – a positive and unanticipated result given the ongoing political and economic uncertainties. The busiest sectors included TMT, pharma, financial services and infrastructure.

There may however be cause for more caution for the global M&A market in 2019. The situation in China, the threat of trade wars, the continued uncertainty of Brexit for the UK and Europe, the global trend for greater protectionism and the tightening of debt markets are some of the indicators that the market may be more subdued than in 2018.

However, despite this, there remain reasons to be optimistic that 2019 will be a strong year for M&A. Private equity houses have

Many boards are under pressure to sharpen their strategic focus

significant amounts of cash raised in recent years that they are under pressure to invest and they seem willing to target higher value companies. Many boards are under pressure to sharpen their strategic focus, which may result in disposals, and to move forward in the face of rapid technological change, which may result in acquisitions.

One persistent theme on M&A in recent years is disruption – and it is something we will see more of in 2019, whether by politicians, anti-trust regulators, shareholders or others.

Political intervention in M&A transactions will continue to rise

2018 saw a number of jurisdictions which have historically been open to foreign direct investment (FDI) become more restrictive and interventionist. These governments are seeking to preserve their country's position in a global market while protecting their national security by intervening in transactions in sensitive sectors, such as national security. It is worth noting that the concept of national security is being extended beyond traditional defence-related activities to include critical infrastructure, communications assets and advanced technology.



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Gavin Davies has 23 years of experience supporting international financial investors and multi-national corporate clients on cross-border M&A and investments across Europe and Africa. He regularly advises on matters involving complex or novel structures, contentious situations and distressed situations. Gavin has strong sector experience in technology, media & telecoms, real estate and financial services. He also advises the Government of Sierra Leone on a pro bono basis and chairs the board of the International Senior Lawyers Project UK, the leading international charitable organisation providing the skills of senior lawyers to promote human rights, sustainable economic development and the rule of law worldwide.

Gavin is recommended as a "Leading Individual" in the UK Legal 500, recommended in Who's Who Legal Global M&A as a leading practitioner in international M&A ("clients full of praise for his 'technically astute and diligent approach', 'an absolute pleasure to work with'", and has been identified in Chambers UK as a High End Capability M&A lawyer ("gives 'very clear and categorical advice' and is 'highly impressive technically and highly experienced and down to earth'"). He has twice led teams winning Financial Times Innovative Lawyers Awards, in 2009 and 2016.



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Caroline is a partner in our corporate team specialising in cross-border public and private M&A. Caroline advises leading corporates and financial institutions on private acquisitions and disposals, recommended and hostile public company takeovers, joint-ventures and equity capital raisings. Caroline works with clients across a range of sectors, with a particular focus on financial services. She has worked on a range of matters in the fintech sector.

Caroline also works with a number of our listed company clients on corporate governance and board advisory matters, listed company regulation and compliance. Caroline has been recognised in The Lawyer's Hot 100 for "her legal prowess in major public takeovers".

The Committee for Foreign Investment in the United States (CFIUS) is the most high profile regime to become more interventionist but there are many others, including the EU, France, Germany and the UK, which are all introducing or considering regimes with a broader scope and/or greater powers to intervene.

In order to minimise the potential for disruption to a deal, it is important to identify and engage with any likely FDI issues early in any cross-border M&A transaction.

Anti-trust regulators are also becoming more active

Anti-trust regulators have greater powers and

are growing in confidence – their willingness to take bold and sometimes unpredictable decisions can derail, or at least delay, a transaction. We are seeing them being more proactive in investigating transactions and more willing to co-operate on an international scale. They are also broadening their focus beyond existing market competition to the potential impact of a transaction on innovation and R&D.

We are also seeing more enforcement action for procedural infringements, including where inaccurate or misleading information is provided during the course of an investigation or where a buyer begins to exercise control over the target before receiving merger control clearance (known as gun-jumping).

Parties must identify any necessary merger control filings, which may be required even in jurisdictions where a target has no or limited connections, and ensure that they do not fall foul of the procedural requirements of anti-trust regulators in relevant jurisdictions.

Investors and shareholders are forming their own views

Shareholders no longer simply follow a board's recommendation but are willing to form their own views and, if they disagree with a board's proposals, challenge a proposed deal, whether by voting it down, agitating for a price change or putting public pressure on a board to withdraw or amend a deal.

To a large extent, this is due to the influence of activists, whose monetary firepower and geographical spread continues to grow. Activists are willing and able to take on larger targets around the world, with no company now being viewed as too large to target. However more traditional institutional

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investors are also asserting their views and compelling boards to take their views into account.

Boards must consider their shareholders' views when contemplating an M&A transaction and, if appropriate, sound out key shareholders ahead of a transaction.

Acquiring technology and the importance of the individuals behind it

Technology-related M&A is on the rise, both for tech and non-tech companies. With the rapid pace of technological change, non-tech companies are using tech-acquisitions to move into new markets or adapt and evolve in their existing markets.

Retention of the individuals behind the technology is often as important as acquiring the technology

The retention of the individuals behind the technology is often as important as acquiring the technology – the value of the technology and the ability of a company to integrate it can quickly diminish without the continued involvement of the individuals behind it. We are therefore seeing corporates adopting private equity style management incentivisation programmes to motivate these individuals and adapting their internal governance arrangements to ensure that the corporate culture does not stifle innovation.

We are also seeing more “corporate venturing”, where a corporate takes a stake in a company such as a technology company in its early stages, to enable the technology to be developed in collaboration with, but not under the full control of, the corporate.

Third party interlopers

2018 also saw a rise in competitive transactions, including the high profile contests for Sky and the assets of 21st Century Fox. Whilst competitive bids can lead to an increase in the price paid, the competing bidders may instead join forces to acquire the target together. Interlopers may also make an intervening bid for the bidder rather than the target – sometimes leading to a successful bid by the interloper but sometimes resulting in both transactions failing.

Dealmakers need to pay more attention than ever to the other possible constituencies in an M&A deal

Eyes in the back of your head

There are some positive signs for a good year for M&A in 2019, despite the ongoing political and other uncertainties. What is clear is that disruption from third parties to the M&A process will continue and dealmakers need to pay more attention than ever to the other possible constituencies in an M&A deal, beyond the buyer and seller.