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RISING VALUATIONS COULD ALTER ACQUISITION FINANCING OUTLOOK

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Legal Briefings – By **Stephen Wilkinson**, **Roddy Martin**, ..., **Andrew Rich** and **Frédéric Bouvet**

The continued valuation gap between buyers and sellers may cause corporates to rethink their methods of financing deals.

M&A is the top priority when it comes to corporate capital investment, according to Herbert Smith Freehills' new cross-border M&A survey *Beyond Borders*. While capital investment was a clear priority for businesses three years ago, it is now cited as most important by only 38% of respondents compared to 45% who are focused on M&A, a significant increase on three years ago (36%).

However, the acquisition appetite could be choked somewhat by the continued valuation gap between buyers and sellers, which has seen deal value reach record levels. Indeed, respondents said that the gap between the buyer's and seller's valuation of the business was a stumbling block in just over a fifth (21%) of deals – the second most common issue after legal challenges, stated by almost a third of respondents (28%).

In addition, the next two years could see a paucity of strong assets as almost half (46%) of respondents in the survey said that they have no intention of making any divestments at all.

Given the high volume of respondents who are intending to make acquisitions, competition for the best assets could fuel even higher valuations. And with banks pulling back from underwriting loans for acquisitions, it is likely that both corporates and private equity (PE) will have to broaden their horizons in terms of acquisition financing.

"We continue to see a number of markets where there is competition to lend to investment grade corporates which has meant that debt remains keenly priced," says Kristen Roberts, partner, finance at Herbert Smith Freehills in London.

“Further down the credit curve, if creditors begin to ration debt availability or the appetite to fund increasing acquisition price multiples weakens, the cost of that debt will rise and, in order to adequately leverage themselves, corporates may have to utilise their entire group balance sheet through group guarantee and potentially security structures.

“In the PE space, whilst increased pricing will be an option, along with a greater range of sub-ordinated debt instruments than are realistically available to listed corporates, this rationing may also see higher equity cheques than we've seen in recent years.”

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