



# M&A Growth Strategy in 2016 : Markets Aspects

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The background is a dark blue gradient with several large, semi-transparent gears of various sizes scattered across it. On the left side, there is a vertical strip with a colorful, abstract, and somewhat pixelated texture in shades of orange, yellow, and brown.

# 1. Environment

- ✦ **Uncertainty**
- ✦ **Divergence**
- ✦ **Markets elements**

# 1.1. Uncertainty

- ★ **Politics : US elections on Nov.8, 2016  
(Wall Street preferred candidate unclear)**
- ★ **European confusion**
  - ❖ **Brexit**
  - ❖ **Lack of vision**
  - ❖ **Lack of authority**
  - ❖ **Lack of common goal**
- ★ **Geopolitical risks**

## 1.2. Divergence in economic fundamentals globally

- ★ **US economy : Strong US data**
- ★ **European economy**
  - ❖ **Germany and UK**
  - ❖ **Other countries**
- ★ **China : Positive growth but in slowdown mood**
- ★ **Emerging countries : disappointing beginning of the year**

## 1.3. Markets elements

- ★ **US recent hike in interest rates by Fed**
- ★ **ECB never ending extension of QE?**
  - ❖ Interest low for long (?)
  - ❖ Negative interest rates
  - ❖ Negative deposit rates
  - ❖ Next : negative bond issuance for corporates (?)
  - ❖ Proper reflection of credit risk (?)
- ★ **Commodities**
- ★ **Equities : new / old economy**
- ★ **FX : Strong USD/CHF, “weak” EUR, quid UK£?**

# 2. How to create value for shareholders in 2016

## ★ Main Drivers

- Low financing costs
- Weak equities
- Strong US fundamentals and strong USD
- New players (China)

## ★ Expectations

- On dividend distribution (even in the commodities industry)
- Better use of the cash on balance sheet (negative interest rates)
- IG and non IG expectations may vary
- Capex reduction (but subsequent decline in growth)
- Be profitable in an extreme volatile environment (the new normal)

## ★ Discipline

- Cost of capital
- Price
- Shareholders
- Activist firms to restore capital efficiency

## 2. How to create value for shareholders in 2016 (Cont.1)

- ✦ **Top line growth**
- ✦ **Expansion in new geographical areas**
- ✦ **Access to new markets/customers**
- ✦ **Strategic positioning**
- ✦ **Overall improving profitability**

## 2. How to create value for shareholders in 2016 (Cont.2)

### ★ M&A as an answer :

- 2015 record year for large deals (70 > 10B USD)
- “Easy” financing
- Structuring trends
  - Hedging
  - Rating
  - Legal
  - Accounting : NOL, D/E ratio, Covenants
  - Tax : US inversions, leverage, WHT,
  - ROIC



## 2.1. M&A Basics

- Due diligence required (unlisted or listed target)
- Valuation
- Price is different from value
- Payment considerations (earn out etc)
- Anti-trust
- White-horse
- LOI, SPA, Reps&War, MAC, EoD, Arbitration, Earn-out
- Potential consequences in case of failure (before/during/after the deal)

➡ M&A benefits the seller (merger premium)

## 2.2. M&A structuring

- ✱ **A buys B shares to Company C ? Too simple**
- ✱ **Why structuring M&A deals?**
  - ❑ **Impact cost of debt**
  - ❑ **Extracting value from the target quickly**
  - ❑ **Use of existing NOLS / DTA provide financial value**
- ✱ **Market hedging opportunities (timing elements)**
  - ❑ **When deal is certain : Forward**
  - ❑ **When deal is likely : Contingent hedges**
  - ❑ **When deal is approximately 50/50 : Options**

# M&A structuring limitations?

- Arm's length transfer prices, thin-cap, anti abuse rules...
- BEPS / OECD
- Competition anti-trust rules
- U.S. has one of the most strict and detailed legislation, but EU and almost all major countries have adjusted their legislation
- Financial penalties for violation of the rules can be severe (everywhere)

➔ No excessive push down but room for enhancing use of existing DTA/NOL, hedging and allocating “fairly” part of the M&A cost of financing

## 2.3. Need for discipline in 2016

- **Lessons learned : Easy to buy, hard to perform**
- **Classic failures :**
  - ❑ Poor due dil and negotiations,
  - ❑ Lack of planning,
  - ❑ Management of culture issues,
  - ❑ In house strategy only (no financial and legal advisors),
  - ❑ Limited synergies,
  - ❑ Markets elements (Markets open or not, FX in cross-border deals, IRS hedging?),
  - ❑ Merger of equals,
  - ❑ Valuation and price setting,
  - ❑ Fraud,
  - ❑ Basics forgotten eg earn out, MAC clause, Market disruption...

## 2.4. Opportunities

- Cutting capex and increasing share repurchase operations are rarely sufficient to counter decline in cash flows : M&A needed
- Negative interest rate and available/excess cash support M&A
- Sectors old/new economy, Internet, Pharma, AirSpace, Commodities?
- Think : Volatility, Timing, Hedging, Rating, ROIC (increase operating results and decrease operating costs), Structuring and Profitability.

➡ **Cautiously optimistic for 2016**