CORPORATE DEALMAKER UPDATE

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DEALMAKER'S DISH:
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The Deal

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The Federal Reserve's decision to begin tapering its bond buying program is likely to put a dent in M&A activity in 2014 because it will likely lead to higher interest rates, making deal financing more expensive, according to a panel of experts. With deal pricing at the highest level in years, megadeals worth over $10 billion may not be as common in 2014 as they were in the previous year.

The outlook for the deal environment was the subject of Dealmaker's Dish, a roundtable discussion at The Deal Economy 2014, a conference held at the New York Stock Exchange on Dec. 5, 2013, and presented by The Deal and law firm Pepper Hamilton.

The panelists included **Jeff Barton**, **vice president of licensing and acquisitions** at Abbott Laboratories; **John Doherty**, **senior vice president for corporate development** at Verizon Communications and Verizon Ventures; **A. Roger Marinzoli**, **senior managing director for M&A** at asset manager TIAA-Cref; **Bill McNichols**, **senior vice president** of Starbucks; and **James D. Rosener**, chair of Pepper Hamilton's International Practice Group and managing partner of their New York office. The discussion was moderated by **Jeff Kanige**, **editor-in-chief** of The Deal.

The discussion took place against a background of a strong second half in M&A activity in 2013. Global M&A volume was $2.8 trillion in 2013, according to Dealogic, compared to $2.5 trillion in 2012. However, the number of deals declined from 42,169 in 2012 to 35,899 in 2013.

A similar pattern was evident in the U.S., with $1.1 trillion in deals recorded in 2013, compared with 927,353 in 2012, according to Dealogic. The number of deals declined by 18%, but 18 of those deals were worth more than $10 billion, including Verizon's $130 billion acquisition of the 45% of Verizon Wireless owned by the U.K.'s Vodafone.

The panel agreed that the deal environment would be greatly affected by the mood in Washington. On December 18, Congress approved a budget deal that avoids a government shutdown similar to the one that took place in October. Also in December, Fed Chairman Ben Bernanke announced at his final press conference that the Fed would reduce its bond buying from $85 billion a month to $75 billion, the start of a long-envisaged tapering of intervention that is expected to lead to higher interest rates.

McNichols said that "clarity in terms of a path to more coherence in Washington is positive which helps M&A and helps confidence."

Marinzoli added that financial institutions have been suffering because of years of low interest rates. "One of the biggest things that has been impeding companies in the banking and insurance sector has been the low interest rate environment, which is great for consumers but difficult for companies that have asset management under their belts that rely on fixed income," he said. Marinzoli noted that when interest rates began falling in 2004, a massive run up occurred in M&A activity.

He added that higher interest rates "would be an impediment to getting more deals done because you do have low-cost financing now."

But interest rates are just one part of the M&A equation. Low rates have pushed investors into equities, which has driven up the stock market valuations of many companies. "A lot of money has flowed back into the equity markets and it's

LEFT TO RIGHT WILLIAM MCNICHOLS, A. ROGER MARINZOLLI

LEFT TO RIGHT JOHN DOHERTY, JEFF BARTON, JAMES D. ROSENER

generally had a significant impact on the affordability of commercial stage assets," Barton said.

Doherty described the current market as "a little frothy," while McNichols commented that, on the consumer side, the market is fully priced. "I think that the onus is on the acquirer to make sure that you're comfortable paying a frothy multiple," he said.

Marinzoli pointed out that about 60% of the megadeals from the 1990s turned out not to be effective mergers. He noted that there were many more deals over $10 billion in 2013 than in the previous two years. "If prices continue to rise, will you still see those large deals happening next year?" he asked. "The pricing may impede big deals from happening."

On the other hand, McNichols said higher interest rates might actually benefit the deal process by driving down equity prices. "There's a disconnect between what private market value looks like and what some folks think are comparable on the public side, so I think a narrowing of those differences is probably a good thing for deals," he said.

Turning to cross-border M&A, Rosener noted that he had just returned from a business trip to Paris, where he found an upbeat mood. "You know last year the general mood in Europe was barely above suicidal," he said. "It was actually a fairly confident change. A lot of the talk in Europe is investment opportunities in Spain, where people think that it's getting close to bottom, and the same is true in Italy and Portugal. Smart money is starting to get raised to invest in that."

Marinzoli said that TIAA-Cref had made a major investment in the U.K., the biggest it has yet done. "By the middle of 2013 we were confident enough to say we have visibility, so let's do this deal," he added.

McNichols agreed that Europe has started to stabilize. "We comped positive on our stores for the last quarter in Europe, which was I think tremendously encouraging for us," he said. He added that business was also booming in China, where Starbucks had just opened its 1,000th store. "We love China and we love participating in the Chinese economy. I do agree that pricing for the private companies or companies there is extraordinarily high."

Barton said that China was a key market for his firm. "It's certainly not easy," he added.

"China is such an important market and all the demographics are going the right

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way for a company like Abbott," he said. "It is a challenging place to invest due to some of the regulations that the government has pursued and the valuation of the companies there. So it requires a lot of work."

Looking to 2014, the panel agreed that instead of megadeals, it was likely that companies would focus on smaller acquisitions to round out their businesses. "I would expect things are going to be smaller," said Verizon's Doherty. "It's going to be more about buying and capabilities. Filling in gaps that we have within our portfolio, adding to the platforms that we have so we can put a better service into the market and you don't need to do $40-50 billion deals to do that."

McNichols agreed. "We have the perspective that small to midsize deals feel right from an execution and an integration standpoint," he said. "The hard part is bringing it in and folding it in and making it work inside the existing bigger business and, as you go up in size, the complexity of that integration increases exponentially.

Abbott's Barton said that he expected the company to be some startup companies because there is maturing technology in the medical sector. "But I also think we'll be interested in expanding our emerging market presence in Asia and Latin America," he said.

Doherty noted that in addition to making acquisitions, he believed a lot of companies would be selling divisions that no longer fit their business models. "Don't be surprised if you see us shed an asset or two as well," he said. "I think that's healthy." ■