Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Trends In Public-Target Mergers: Takeaways From ABA Study

By **Claudia Simon, Schulte Roth & Zabel LLP**

Law360, New York (January 11, 2017, 12:13 PM EST) -- The M&A Market Trends Subcommittee of the Mergers & Acquisitions Committee of the American Bar Association's Business Law Section recently released its annual Strategic Buyer/Public Target Deal Points Study. The study covers numerous commonly negotiated deal points in acquisition agreements of U.S. public targets by strategic buyers for transactions announced in 2015.

As the chairwoman of this project, I had the pleasure of working with a group of experienced mergers and acquisitions lawyers from several major law firms. The attorneys in the working group helped compile the raw data underlying the study's results. We aimed to provide a thorough study for M&A practitioners who are trying to determine what's market in deals involving acquisitions of U.S. public targets. Thanks to the working group's efforts, over the past 13 months we have doubled the number of data points covered by the study.

Sample Overview

The final study sample included 133 acquisitions ranging in value from $205 million to $65 billion, with an average transaction value of $6.35 billion. This year's study covers more deals than last year's study and reflects a large increase in the average size of deals (up from $3.8 billion last year), with the technology, financial services and pharmaceuticals/biotechnology industries continuing to generate the largest percentage of deals. Once again this year, foreign buyers comprised approximately 25 percent of the acquirers of U.S. public company targets. The foreign buyers predominantly arose from the European Union, followed by Japan and Canada.

New Data Points

This year our working group added over 40 new data points covering topics such as treatment of equity awards, employee benefits provisions, antitrust covenants, pricing formulations in stock deals, collars, definitions of "intervening event" in fiduciary outs, and other issues that we've found to be hotly negotiated in these transactions. Also, for the first time, we went beyond the four corners of the merger agreement and looked at provisions in stockholder support agreements, which are agreements entered into contemporaneously with the merger agreement to ensure that certain stockholders will tender their shares and/or vote to approve the transaction. We also sifted through disclosure of the background of these transactions in U.S. Securities and Exchange Commission filings to determine whether targets had agreed to a pre-signing exclusivity period with the buyer.

Significant Trends

Closing conditions were generally relaxed. For example, fewer deals included closing conditions regarding litigation or appraisal rights, and more deals only required the target's representations to be true at closing to a "no material adverse effect" standard, rather than requiring representations to be true "in all material respects." At the same time, deal protections were tightened. The average breakup fee in our study increased from 3.4 percent of equity value to 3.5 percent of equity value, despite the fact that average transaction values increased from $3.8 billion to $6.5 billion. Typically, you would expect to see a lower percentage as the transaction value goes up.

Similarly, we saw significant increases in breakup fee triggers. A breach of the no-shop covenant triggered a breakup fee in 50 percent of deals, whether or not it resulted in a superior proposal. This is up from 42 percent in last year's study. Additionally, a buyer's termination of the merger agreement after the outside date, combined with a competing acquisition proposal, triggered a breakup fee in 86 percent of deals, up from 77 percent last year. Moreover, in 50 percent of deals, the competing acquisition proposal only had to be known by the board, not publicly disclosed. This is up from 32 percent in last year's study.

Along the same lines, buyers imposed tighter limits on fiduciary outs. For example, only 12 percent of deals expressly allowed a target board of directors to change its recommendation to stockholders for any reason required by its fiduciary duties, down from 20 percent last year. The other 88 percent of deals limited the board's right to change its recommendation to specific situations involving a superior proposal or intervening event. Also, 43 percent of all-stock deals did not allow the target to terminate the agreement for a superior proposal, up from 29 percent last year. In deals that allowed the target to terminate the agreement for a superior proposal, 94 percent gave the buyer a continuous right to match the competing proposal, up from 89 percent last year.

The results suggest that parties were focused on bringing these megadeals to a successful closing using looser closing conditions and tighter deal protections.

Increasing Popularity of Mixed-Consideration Deals

Mixed-consideration deals are extremely popular. Thirty-eight percent of deals in our study included both stock and cash in the merger consideration, which is the highest percentage of mixed-consideration deals we've seen since we began tracking this data in 2004. When I first saw the results, I wondered if parties were structuring deals this way to avoid a buy-side stockholder vote, which is required by stock exchange rules when a buyer issues more than 20 percent of its outstanding shares to stockholders of the target company. However, when we took a closer look at the deals, we saw that almost half of the mixed-consideration deals still required a buy-side vote, so this does not seem to be the driving factor. Parties may be taking advantage of other benefits of mixed-consideration deals. For example, using cash as part of the consideration mitigates the risk of fluctuations in the buyer's stock price between signing and closing due to market changes. It also reduces the risk to the buyer's stockholders that the expected synergy value embedded in the acquisition premium will not materialize. In an all-cash deal, the buyer's stockholders take on this entire risk.

Surprising Trends in Tender Offers

Surprisingly, we saw a drop in the percentage of all-cash deals structured as tender offers rather than mergers, despite the significant timing advantage provided by tender offers. Cash tender offers were completed in an average of 62 days compared to over 165 days for cash mergers. Moreover, in 2013 Delaware adopted Section 251(h) of the Delaware General Corporation Law, which eliminates the need to obtain stockholder approval for the second-step merger following a tender offer as long as the buyer acquires sufficient shares in the tender offer to approve a merger (i.e. a majority of outstanding shares on an undiluted basis). Practitioners expected the percentage of cash deals structured as tender offers to increase as a result of the adoption of Section 251(h). Instead, the percentage is lower than we saw in 2008.

Another surprising trend is that many parties continue to craft the minimum tender condition on a fully diluted basis despite the adoption of DGCL Section 251(h). The minimum tender condition is among the most important conditions to a tender offer. It specifies the number of shares that must be tendered before the buyer is required to accept the shares for payment. The minimum tender condition cannot be waived and is typically set at the lowest level of ownership that would permit the buyer to acquire 100 percent of the target in the second-step merger. As noted above, if the target is a Delaware corporation and Section 251(h) applies to the transaction, the lowest level of ownership would be a majority of the target's outstanding shares on an undiluted basis. However, in this year's deal points study, almost half of deals continue to use a fully diluted formulation and almost all of these deals opted into Section 251(h). If parties calculate the minimum condition on a fully diluted basis rather than an outstanding basis, the percentage of stockholders who must tender can be significantly higher than the percentage of stockholders required to approve a merger. I am surprised that parties would choose a higher approval threshold than actually required by Section 251(h).

Emerging Trend — Exchange Offers

A new trend is emerging toward stock deals structured as tender offers, also referred to as exchange offers. Between 2007 and 2013, we saw only five friendly exchange offers involving U.S. targets with a transaction value over $200 million, and none in 2014. The prevailing view was that the timing advantage provided by tender offers is much less pronounced if stock consideration is involved, because the buyer must first file a registration statement with the SEC registering the securities being issued as consideration. The completion of the exchange offer cannot occur until the SEC declares the registration statement effective. However, in 2015, six friendly stock deals over $200 million were structured as exchange offers, and they were completed in an average of 55 days compared to more than 165 days for stock mergers. Parties have managed to clear the SEC review process in exchange offers on an expedited basis. The benefits of speed are obvious — stockholders receive consideration for their shares sooner, there is less risk of fluctuations in the value of the buyer's stock consideration due to market changes, less risk of competing bids, less time for a material adverse effect to occur, less time for employees to become distracted, and less time for the business to be subject to restrictive operating covenants. Because of these timing benefits, I expect the exchange offer to become the structure of choice for stock deals that do not require a buy-side vote or involve a lengthy antitrust or regulatory review process.

Claudia K. Simon is a partner in the Washington, D.C., office of Schulte Roth & Zabel LLP. She is the chairwoman of the American Bar Association's Strategic Buyer/Public Target M&A Deal Points Study.

Click here to access the 2016 study (requires membership in the ABA Section of Business Law).

lawyers effectively and efficiently complete their daily tasks. For more information on Lexis Practice Advisor or to sign up for a free trial please click here. Lexis is a registered trademark of Reed Elsevier Properties Inc., used under license.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.
