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Lawyers Optimistic About 2011 Deals Marketplace

By **Pete Brush**

Law360, New York (January 1, 2011) -- With companies sitting on a $1 trillion mountain of cash and the lending market finally starting to thaw, corporate finance lawyers are preparing for a busy 2011 on the deals front, they told Law360.

“I think 2011 is going to be stronger than 2010 in deal activity worldwide. There is a lot of cash sitting on balance sheets and you definitely see higher confidence in the marketplace,” said George A. Casey, co-head of Shearman & Sterling LLP's global mergers and acquisitions group.

Casey noted that 2010 was stronger than 2009 on the global M&A front in terms of overall dollars invested and he expects the trend to continue — with Latin America becoming especially active.

In the U.S., 2010 was relatively weak in terms of overall M&A dollars, attorneys said, but they have seen marked increases in deals — and deal interest — domestically since about August.

Sectors that appear to have strong M&A potential include health care, information technology, consumer products and banking, lawyers said, adding that so-called middle market deals, sized from about $50 million up to about $500 million, are likely to be the "sweet spot" for the coming year.

Higher stock prices are likely to embolden would-be strategic buyers, according to Ariel J. Deckelbaum, deputy chair ofPaul Weiss Rifkind Wharton & Garrison LLP's corporate department.

"Only now are people feeling more comfortable about where their stock prices are settling," Deckelbaum said, adding that when a strategic buyer's share price "reflects a full valuation," a company typically is more willing to use shares instead of cash to make deals.

A study released by Deckelbaum's firm noted that cash was the exclusive consideration in only half as many transactions from Aug. 1, 2009 through July 31 as it was in the previous year-long period.

The corporate cash pile is by all accounts the largest, and according to Patrick Daugherty of Foley & Lardner LLP's corporate, M&A and finance practice, big companies are coming under pressure either to get into the strategic deals market or hand the loot back to stockholders in the form of dividends — something they don't necessarily like to do.

"At some point in time — and we're coming to it — the hoard of cash will grow so large and confidence will improve to a point where investors say 'Enough's enough, what are you doing to do with the cash?'” Daugherty said. "As a result, companies are driven to make acquisitions."

Moreover, according to Daugherty, corporate cash is just one of three immense piles of money ready to be invested: with private equity and bank dollars representing the other two.

The investment banking analysis firm Accordion Partners LLC estimated at the end of November that private equity funds currently "have more than $450 billion in dry powder to deploy."

“Private equity is sitting on more cash than it likes to,” Daugherty said. “It's been hard for private equity groups to deploy it. They like to do that on a leveraged basis but the banks weren't lending.”

Since at least summer's end, however, that has changed, with bankers picking up the phone and telling M&A players they're open for business and even offering better lending multiples for private equity to leverage.

Creating yet more pressure on private equity firms to do deals, according to some lawyers, is the fact that money allocated during the pre-bust years of 2004 through about 2006 may be approaching time limits for how long it can remain pent up before it has to be used, returned to investors, or renegotiated.

Jonathan K. Layne, co-chair of Gibson Dunn & Crutcher LLP's M&A group, also points out that global financiers like Citigroup Inc., Deutsche Bank AG, JPMorgan Chase & Co. and Bank of America Corp. want to move back in on the lending front.

Additional reasons why 2011 looks like a better year for M&A, according to Layne, are recent increases in investor appetite for high-yield corporate bonds, continued low interest rates and the current state of play in Washington.

Recent news of extended George W. Bush-era tax cuts, one of the first products of the recent Republican takeover of the U.S. House of Representatives, was one example of the kind of divided government deal that likely would be good for markets, Layne said.

Historically, divided federal governments have helped markets flourish, Layne said, adding "I never want to see one party controlling the House, Senate and White House."

With many signs pointing to a stronger M&A market generally, the potential for bidding wars also increases, several lawyers pointed out.

“I think you'll see more auctions as confidence grows," said Michael E. Hollingsworth II, co-head of Nelson Mullins Riley & Scarborough LLP's M&A group. “The better the market, the more auctions. It goes hand in hand. Sellers are always analyzing their leverage. If sellers think they can squeeze more value out of the sell-side process, they are going to.”

Even the shaky initial public offerings market is seeing an increase in investor appetite, according to Susan E. Pravda, Foley & Lardner LLP's Boston managing partner and private equity and venture capital team member.

A steady market for IPOs in 2011 is probably not in the cards, but even an unsteady market is better than no market at all and has the potential to increase the perceived value of targeted companies, she said.

"Remember we're coming from 2008 where there were no IPOs,” Pravda said. “Overall, 2011 will be as good as or better than 2010. And if you think you can IPO for $500 million, you're not going to sell for $250 million.”

Lawyers uniformly warned that certain problems persisted — most notably burgeoning sovereign debt issues in parts of Europe and long term, potential deficit problems in the U.S. — and allowed for the possibility of economic shocks that could curtail M&A activity.

Another potential problem, is the fear of rising inflation, according to Daugherty. The business world sees inflation as a long-term problem, he said, and such fears could add to buying momentum in “hard asset” sectors like real estate and commodities as M&A investors look for hedges.

Overall, according to Deckelbaum, as equity markets have lurched ahead in the wake of a disastrous few years, M&A players have developed stronger stomachs.

“People have gotten more accustomed to the volatility and the shocks in the system — we view them now as bumps in the road,” Deckelbaum said.

Of this, attorneys also said it was playing into a real sense of optimism that 2011 will bring at least a partial return to the better days of dealmaking.

“There's a whole new attitude toward the markets. We keep getting calls about new deals. I definitely haven't been this busy since about 2005,” Hollingsworth said.