Dear Valued Reader,

Welcome to the January 2016 edition of the Venue Market Spotlight. To kick off the New Year, we will examine the current outlook for companies looking to add value through selling assets.

In 2015, the value of spinoffs, carve outs and divestitures rose to a post-crisis high, helping propel a record year for M&A activity overall. According to Mergermarket data, the value of corporate asset sales rose to US$523.6bn in 2015, up from US$403.9bn in 2014, although deal volume dipped to 820 from 837 a year prior. The financial services sector led the way with US$134.3bn in such deals, headlined by General Electric’s shedding of its banking assets for over US$40bn due to regulatory concerns.

In a year when valuations soared and profitability became ever more challenging to achieve, companies sought to cash in on prized assets when possible. The largest spinoff came in June 2015 when eBay separated its PayPal division in a deal worth US$50bn. Firms in the troubled energy and mining sectors sold off assets, by contrast, in an effort to keep their footing amid a global rout in commodities prices.

Economic tremors have shaken the corporate landscape in early 2016, and respondents to our survey expect this volatility to drive increased asset sales as companies focus on their core strengths. Europe is expected to see a boom in activity due to debt concerns, while firms in the commodities business are seen as likely to accelerate their efforts to slim down. At the same time, the prospect of low valuations could make some companies think twice about shopping their assets.

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As always, thank you for your interest in this month’s Spotlight.

Sincerely,

Tom Juhase
President, Financial Services Group
Amid a record-breaking year for deals in 2015, the value of corporate spinoffs, carve outs, and divestitures rose as well to US$523.6bn, a 30% year-over-year increase. Deals of that type, driven by concerns such as compliance costs and tax benefits, made up 12% of the global M&A total. In terms of geography, both North America (US$296.3bn) and Asia-Pacific (US$108.6bn) saw the value of such deals reach a record high.

The highest number of US$4bn-plus asset sales occurred in the financial services sector, with mega-players GE Capital, HSBC, and Deutsche Bank all selling off big pieces. In the case of GE, investors had become increasingly concerned about ballooning regulatory costs, prompting the blue-chip to shed its banking assets. In the pharmaceuticals industry, hospital-supply company Baxter International spun off its biopharma business, Baxalta, in a tax-free US$17.9bn deal.

Looking at the coming 12 months, dealmakers have their sights set on the energy, mining, and utilities sector, as the price of oil has slid to a 12-year low. Freeport-McMoRan, the largest US mining company, is exploring asset sales after reporting a US$3.8bn loss in Q3 2015. As worries mount about the state of the world economy, companies may also divest to focus on their core business and unlock value.

Respondents to this month’s Spotlight survey universally think corporate asset sales will either remain the same (20%) or increase (80%) in the next 12 months, and 16% think they will increase significantly. The region drawing the most attention is Europe, with 92% of respondents saying it will be among the top two regions in terms of asset sales, while 44% say Asia-Pacific will be in the top two.

Other key findings include:

- Fifty-six percent of respondents predict that the energy, mining, and utilities sector will be among the top two sectors for asset sales, and 52% say industrials and chemicals will also be in the top two.

- The biggest drivers of asset sales are expected to be improving operational efficiency (56% of respondents), focusing on core competencies (40%), and paying down debt (36%). The most-cited risk in asset sales is low valuations (72%).

- Private equity (PE) firms are widely expected to increase their acquisitions of corporate assets, with 60% of respondents saying PE activity will increase.

The stage appears to be set for a year filled with corporate asset sales. However, respondents are aware that the situation could shift if the macroeconomic winds change, or if valuations drop lower than corporate management teams can stomach.
What do you expect to happen to the level of asset selling by corporates in the next 12 months?

All signs point to a jump in corporate asset sales this year, as 64% of respondents expect them to increase somewhat, 16% say they will increase significantly, and 20% predict the level will remain the same. Many respondents linked their predictions to the volatility racking global markets at the start of 2016. Stocks have slid worldwide and the IMF cut its 2016 growth estimate to 3.4 percent. “Economic conditions are not good and many regions are slowing down,” says an M&A director at a corporate, who says asset sales will increase somewhat. “Companies will have to rethink their strategies and make drastic decisions.”

Debt and increased risk of default are a concern as well—the US corporate debt burden has risen 59% since 2010 to US$5.6tn, according to Barclays. “Companies are restructuring and carving out assets that are not very profitable or don’t contribute much to the company,” says a private equity managing director, who predicts that corporate asset sales will increase somewhat.

On the other hand, a managing director of a PE firm says global volatility will cause companies to sit tight for the time being, causing asset sales to stay flat. “With the way markets have been going, the next few months will be a game of wait and watch,” he says.

In which sector(s) do you expect to see the most asset sales by corporates in the next 12 months? (Select top two)

The energy, mining, and utilities sector will stand out in terms of asset sales, according to 56% of respondents, while 52% say companies in the industrials and chemicals sector will also be active sellers. The precipitous fall in the price of oil to below $30 a barrel is the primary reason to expect a selloff in the energy sector, says a managing director at a PE firm. “The significant drop in crude prices and the lack of capital for development have hit the industry hard, decreasing profit margins,” he says.

About a quarter of respondents predict many asset sales in the consumer sector (28%), the pharma, medical and biotech industries (28%), and in financial services (24%). Regulatory pressures have continued to drive sales of financial assets in early 2016, as insurer MetLife announced a plan to divest part of its US life-insurance unit to ease its capital burden under new requirements. “Financial assets will be restructured to minimize the risks of non-compliance or fraud,” says a director at a consumer corporate. “Companies will also carve out their non-performing portfolios to improve revenues.”

REGULATORY PRESSURES CONTINUE TO DRIVE SALES OF FINANCIAL ASSETS
In which region(s) do you expect to see the most asset sales by corporates in the next 12 months? (select top two)

- Europe: 92%
- Asia-Pacific: 44%
- North America: 32%
- Latin America: 32%

What will be the biggest drivers of corporate asset selling in the next 12 months? (Select top two)

- Improving operational efficiency: 56%
- Focusing on core competencies: 40%
- Paying down debt: 36%
- Unlocking value by selling non-core assets: 24%
- Prompting from shareholder activists: 20%
- Keeping pace with competitors: 16%
- Generating tax benefits: 4%
- Meeting antitrust requirements: 4%

Close to all survey respondents (92%) think that Europe will be one of the top two regions for corporate asset sales in the next 12 months, followed by Asia-Pacific (44%). The euro area saw growth of just 1.2% over the first three quarters of 2015, while export growth could suffer this year due to the downturn in China and emerging markets, which account for a quarter of euro-zone exports. “In Europe the conditions are deteriorating, capital markets are bad, and the geopolitical situation is tense,” says the CFO at a tech corporate. “It will be hard for companies to sustain themselves without selling assets.”

The poor performance of China to start the year has caused many respondents to predict a rash of divestment in Asia. “China has not been doing well due to the stock market crash, making it difficult for companies to get access to the capital they need,” says a corporate CFO. “They will have to resort to selling off parts of the company if they are unable to raise capital to continue doing business.”

Nearly a third of respondents (32%) expect companies in North America and Latin America to lead the way in asset sales. While respondents largely see economic lethargy in Europe and China, they see a healthy market in North America, resulting in a different rationale for divestment. “North America has started doing well, and businesses there are concentrating on their main businesses and are selling off non-core assets,” says the head of strategy at a corporate.

The three most-expected drivers of asset sales will be improving operational efficiency (chosen by 56% of respondents), focusing on core competencies (40%), and paying down debt (36%). In the current market environment, the importance of efficiency and core strengths goes up, says a managing director at a PE firm. “The need to improve operationally becomes an imperative strategy for boards, given economic instability and market volatility,” he says.

Twenty percent of respondents expect prompting from activist shareholders to drive asset sales, especially given skepticism about debt loads. Bond markets point to low appetite for certain classes of debt – for example, the average yield on the S&P US High Yield Corporate Bond Index rose to 9.3% in mid-January from 7.2% a year earlier. “Shareholder activism is tremendously high, especially in the energy and financial sectors,” says a PE firm managing director. “Failing operations and decreasing margins on profits have caused the investor class and shareholders to want to recoup their finances.”

Despite the prevalence of tax benefits and antitrust requirements as drivers of divestment in 2015, only 4% of respondents say those trends will remain prominent in 2016. A senior director of M&A at a corporate says regulatory hurdles have become a “big challenge” but that “selling non-core assets will always be the main reason for an increase in asset sales.”
What will be the biggest challenges/risks associated with corporates selling assets in the next 12 months? (Select top two)

- Low asset valuations: 72%
- Eliminating synergies within larger company: 28%
- Diminishing market value: 28%
- Losing competitive advantage: 24%
- Losing access to credit/investment for spun-off entity: 24%
- Losing benefits of diversification: 12%
- Removing cost savings achieved through scale: 12%

As markets quaver to start 2016, more than two-thirds of respondents (72%) believe that low valuations will become a major barrier to asset sales. If valuations fall, it would represent a reversal from the trend of last year: the median multiple of assets sold in spinoffs, carve outs and divestments rose from 9.29x EBITDA in 2014 to 9.88x EBITDA in 2015, according to Mergermarket data. “World economies continue to decline, and assets and stocks are trading at values that are significantly less than anticipated,” says a corporate group director of strategy.

About a quarter of respondents predict other challenges to rear their heads, such as the elimination of synergies (28%), diminishing market value for the seller (28%), and loss of competitive advantage (24%). Some companies that downsize may struggle to recover, says a managing director of an investment bank. “It will be difficult for them to get back the profits and competitive advantage they had due to economies of scale,” he says.

What do you think will happen to the level of buying activity of corporate assets by private equity firms?

Respondents broadly predict an uptick in PE activity over the coming 12 months, after a year in which many PE firms stood pat with their capital. In 2015, the total value of PE acquisition deals rose only 5% compared to 2014, while the number of deals decreased by 6%, according to Mergermarket data. However, 40% of respondents expect PE buying activity of corporate assets to increase somewhat in 2016 and 20% say it will increase significantly. “Private equity firms will be active buyers over the coming years, as assets are available at attractive valuations and this will trigger more transactions,” says a managing director of a PE firm.

Just over a third of respondents (36%) think PE acquisitions will remain the same in 2016, while 4% say activity will decrease somewhat. A partner at a PE firm who predicts no change says that private equity has changed its single-minded approach from previous years and no longer focuses exclusively on corporate assets. “PE companies have diversified their investments, buying into startups and other such businesses where they can get good profits,” he says. “Corporate assets may not seem as profitable an option given the choices for PE investors.”

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Notable Q4 2015 Deals in the Room
Venue® data room: A special report

AstraZeneca acquires ZS Pharma
December 17, 2015
Financial Advisor for Target: Goldman Sachs
Counsel for Target: Cleary Gottlieb Steen & Hamilton LLP; Simpson Thacher & Bartlett LLP
Counsel for Buyer: Davis Polk & Wardwell LLP
Industry: Biotechnology; Medical: Pharmaceuticals

Allergan and Pfizer merge
November 23, 2015
Financial Advisor for Target: J.P. Morgan; Morgan Stanley
Counsel for Target: Arthur Cox, Cleary Gottlieb Steen & Hamilton LLP; Cravath, Swaine & Moore LLP; Latham & Watkins LLP; Sullivan & Cromwell LLP; Weil, Gotshal & Manges LLP; Willkie Farr & Gallagher LLP
Financial Advisor for Buyer: Centerview Partners; Goldman Sachs; Guggenheim Partners, LLC; Moelis & Company LLC
Counsel for Buyer: A&L Goodbody; Clifford Chance LLP; Davies Ward Phillips & Vineberg LLP;Debevoise & Plimpton LLP; Morgan Lewis & Bockius LLP; Skadden, Arps, Slate, Meagher & Flom LLP; Wachtell, Lipton, Rosen & Katz; White & Case LLP
Industry: Medical; Pharmaceuticals

CVC and CPPIB acquire Petco Animal Supplies
November 23, 2015
Target: PETCO Animal Supplies, Inc.
Financial Advisor for Target: Goldman Sachs; J.P. Morgan
Counsel for Target: Ropes & Gray LLP
Financial Advisor for Buyer: Barclays; Citigroup; Moelis & Company LLC
Counsel for Buyer (s): Gibson Dunn & Crutcher LLP; TPG Capital LP; Leonard Green & Partners LP; Freeman Spogli & Co.
Industry: Consumer; Retail

Square IPO
November 19, 2015
Issuer: Square Inc.
Counsel for Issuer: Wilson Sonsini Goodrich & Rosati, P.C.; Wachtell, Lipton, Rosen & Katz
Counsel for Underwriter: Simpson Thacher & Bartlett LLP
Underwriter (s): Goldman, Sachs & Co.; Morgan Stanley; J.P. Morgan; Barclays; Deutsche Bank Securities; Jefferies; RBC Capital Markets; Stifel; LOYAL3 Securities; SMBC Nikko
Industry: Computer services; Computer software; Financial Services; Internet / ecommerce

Constellation Brands, Inc. acquires Ballast Point Brewing
November 16, 2015
Financial Advisor for Target: Goldman Sachs; Morgan Stanley
Counsel for Target: Latham & Watkins LLP
Industry: Consumer: Other; Beer; Wine/Spirits

Triton Container International Limited to acquire TAL International Group, Inc.
November 9, 2015
Counsel for Target: Fried Frank Harris Shriver & Jacobson LLP; Shearman & Sterling LLP; Skadden, Arps, Slate, Meagher & Flom LLP
Financial Advisor for Buyer: Wells Fargo Securities, LLC
Counsel for Buyer: Cleary Gottlieb Steen & Hamilton LLP; Sullivan & Cromwell LLP
Industry: Financial Services; Transportation

November 2, 2015
Financial Advisor for Target: Deutsche Bank AG; Goldman Sachs
Counsel for Target: Davis Polk & Wardwell LLP; Fried Frank Harris Shriver & Jacobson LLP; Willkie Farr & Gallagher LLP
Financial Advisor for Buyer: Barclays; Morgan Stanley
Counsel for Buyer: Simpson Thacher & Bartlett LLP
Industry: Computer software; Medical; Services (other)

Dell acquires EMC
October 12, 2015
Financial Advisor for Target: Evercore Partners Inc; Morgan Stanley; Needham & Company, LLC
Counsel for Target: Debevoise & Plimpton LLP; Morrison & Foerster LLP; Skadden, Arps, Slate, Meagher & Flom LLP; Weil, Gotshal & Manges LLP
Financial Advisor for Buyer: Bank of America Merrill Lynch; Barclays; Citigroup; Credit Suisse; Deutsche Bank AG; Goldman Sachs; J.P. Morgan; Lazard; LionTree Advisors LLC, Moelis & Company LLC; RBC Capital Markets Inc; UBS Investment Bank
Counsel for Buyer (s): Black, Burnham & Company LLP; Hogan Lovells International LLP; Simpson Thacher & Bartlett LLP; Wachtell, Lipton, Rosen & Katz
Industry: Computer services; Data processing; Hardware maintenance

IBM acquires Cleversafe
October 5, 2015
Financial Advisor for Target: Houlihan Lokey
Counsel for Buyer: Cravath, Swaine & Moore LLP
Private Equity Firm for Seller (s): In-Q-Tel, Inc.; New Enterprise Associates; Motorola Solutions Venture Capital; Harrison Street Real Estate Capital, LLC; Pritzker Group Venture Capital; Aliso Viejo Partners; Presidio Ventures, Inc.; OCA Ventures; Batterson Venture Capital, LLC
Industry: Computer services; Data processing; Hardware maintenance

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