The flood of inbound M&A and outlook for 2017

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Despite its political turbulence, 2016 was a blockbuster year for inbound mergers and acquisitions in the US. According to Bloomberg, US inbound M&A hit an all-time peak of $586.7 billion, a 35.15 percent hike from 2015. In fact, approximately a third of all US-target deals involved foreign buyers, compared with 21 percent in 2015. These inbound transactions were mainly concentrated in the large- and middle-market sectors, with the most notable deals occurring in the pharmaceutical, materials and energy industries. A primary driver of the foreign interest in US-based deals was China, which saw its total outbound M&A output double year-on-year. This trend is due in part to the slowing of China's economy as companies look to move capital abroad.

With 2016's roaring inbound M&A market in mind, what can we expect in terms of inbound M&A in 2017? For now, most analysts are predicting that the US's cross-border M&A market will cool considerably in this new year, possibly slipping by 35 percent from the previous year. However, this level of M&A activity would still be an impressive figure overall and is indicative of the strong growth the global M&A market has seen over the preceding two to three years. We think the question investors should focus on is whether this rapid cooling will continue as a trend beyond 2018.

Since the current administration has positioned itself as being both business-friendly and populist, the cross-border M&A market could head in different directions. Investors tend to favor deal-making in an environment of deregulation and lower corporate tax rates, which causes transactions to be less cumbersome. Couple these anticipated policy trends with the continual growth rate of the US economy over the past few years, and one could expect a healthy climate for investment in the US that attracts companies from across the globe.

However, President Trump has deviated from the typical GOP policies in significant ways that could alter some investors' strategies for transactions. The first is his campaign promise to block the historic merger of AT&T and Time Warner to prevent further consolidation in the telecommunications, technology and media sector. Trump's seemingly strong antitrust stance on M&A represents a break from Republicans' friendliness towards company combinations over the past several decades. Whether he intends to act on this campaign promise is ambiguous at this time. A sitting president who disfavors industry consolidation adds uncertainty to investors' evaluations of whether to undergo a merger or acquisition.

Another major factor regarding cross-border M&A is Trump's "America First" focus regarding international trade and the industrial base, which could affect foreign parties' interests in cross-border M&A. Although any country could be affected by this policy, certain countries — such as China — may find assessing the impact of cross-border activity more challenging. From a regulatory perspective, these challenges may arise during national security reviews by the Committee on Foreign Investment in the United States. CFIUS is statutorily tasked with determining whether a particular cross-border investment or transaction affects US national security or critical infrastructure assets in the United States. According to Giovanna Cinelli, chair of Dentons' US National Security and Export Controls practice, Congress and several think tanks have taken an interest in analyzing whether the current CFIUS configuration meets stated US policy on security and trade. CFIUS' role has already expanded considerably in terms of scrutinizing

inbound deals for security purposes. President Obama blocked at least two China-US deals during his two terms. (Only one other inbound M&A deal was formally blocked prior to Obama's presidency; however, a number of transactions were mitigated through divestment or restructuring of the transaction.)

Moreover, last September, 16 members of Congress asked the Government Accountability Office to determine whether the "existing processes (including CFIUS, export controls, cyber security and counterintelligence) [are] sufficient to safeguard the national interests threatened by massive Chinese commercial and economic activity in the US" Depending upon the GAO's report, this review may recommend fundamental changes to the CFIUS process to better assess how foreign investment could affect US interests. Given the Chinese government's preference for acquiring sensitive technologies in such industries as semiconductors, aviation and aerospace, the GAO could recommend executive branch revisions to CFIUS, and Congress could revisit the current statutory authority.

In contrast to his three predecessors, President Trump is committed to pivoting, where it is in America's interest, from multilateral, free trade deals to bilateral agreements with stringent stipulations intended to check currency manipulation and the outsourcing of American jobs. President Trump is particularly bullish on substantively limiting China's power in the Asia-Pacific region, promising to levy high tariffs against America's largest source of inbound investment. Whether he will convince Congress to draft legislation enacting his 45 percent tariff on Chinese goods is another question entirely. Analysts speculate that such bold, aggressive moves could ignite a trade war with China and restrict foreign direct investment from there.

Whether this action by the president could hamper M&A itself is debatable. After all, Japanese companies merely shifted their investment style during the US-Japanese economic policy tensions of the 1980s and '90s. To avoid high tariffs, these companies decided to build manufacturing plants in the US rather than export goods. Whether Chinese investors would do the same is hard to say, as is whether investing in brick-and-mortar capital could manifest itself in the form of cross-border M&A. But this style of investing could strengthen rather than weaken the inbound M&A market.

However, more barriers to outbound Chinese investment loom. China already is committed to encouraging investors to focus on transactions at home and in the greater Asia-Pacific region, as shown by its pushing of the Regional Comprehensive Economic Partnership trade deal after the collapse of the Trans-Pacific Partnership. Additionally, the Chinese State Council is considering altering rules to lessen the flow of capital out of the country. Either nudging by the state or an unfriendly economic climate due to rising prices stemming from protectionism could possibly cool Chinese investors' enthusiasm towards the US The Chinese government appears to be coaxing investors towards this behavior with its "One Belt, One Road" initiative, which aims to increase China's role in the Eurasian sphere by incentivizing businesses to invest in infrastructure and businesses in these countries.

In sum, the outlook for foreign investors (particularly those in China) looking to engage in M&A in the US is murky. Industry prognosticators often repeat the old adage that "if there's one thing investors hate, it is uncertainty." In this instance, given the directions the market could swing, foreign investors could simply choose to remain cautious when approaching cross-border M&A in the US, which could result in a cooling in the marketplace. Despite this uncertainty, however, we remain confident in the US market's current robustness. With a stable and growing US economy, an administration committed to increasing US jobs and investing in the country's infrastructure, and the strength of the global M&A market over the past several years, the stage is set for such optimism.

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