

Market Turmoil Stymies Most M&A Activity

With credit hard to come by in the wake of Wall Street's near collapse, fewer acquisitions are being completed

By David Lewis

HOW QUICKLY TIMES CHANGE THESE volatile days. Here's an ironic example: On July 10 in London, Merrill Lynch won *Euromoney's* 2008 Best Global M&A

House award, as well as top honors as Best M&A House in Russia and Best M&A House in Central and Eastern Europe. By mid-September, Merrill Lynch had gone from top expert to helpless target, slated to be acquired by Bank of America for \$50 billion.

Irony was far from the dominant emotion on Wall Street this summer, when the Street was more in primal scream mode. While Merrill was winning all those prestigious awards, it and the United States' other great investment banks—Citigroup, Bank of America, Morgan Stanley, JPMorgan Chase, Goldman Sachs and Lehman Brothers—began announcing asset write-offs totaling \$107.2 billion.

Then Lehman folded, Merrill Lynch folded into Bank of America, AIG became a ward of the federal government and the credit markets, already deeply wounded by fallout from the subprime mortgage disaster, went into deep shock.

Here's another irony: Among top-tier M&A deals, the Merrill-type transaction was one of the few acquisitions going on. "At the moment, the bulk of the M&A activity is focused on the rescue situation, acquisitions of distressed assets and opportunistic acquisitions where strategic buyers feel they can buy assets that are undervalued by the market," said Frank Aquila, partner at Sullivan & Cromwell, the top M&A law firm in the first quarter of 2008, according to Dealogic.

Earlier this year, it seemed a recovery for the M&A market finally could be in sight. This was reflected by two results of July's ACG-Thomson Reuters Mid-Year 2008 DealMakers

Survey. First, the number of M&A pros calling the environment 'good' or 'excellent' sank to 43% from 93% 12 months earlier. Yet 32% of respondents said they believed the number of M&A transactions would rise in the second half of 2008, up from 25% six months before, while 39% said it would remain the same.

Come autumn, that cautious optimism looked like wild euphoria. "It's a crazy time right now," said Craig Sklar, partner in the law firm of Seward & Kissel. "To think that there are only two large, traditional investment banks left—and there are rumors about Morgan Stanley and Goldman Sachs, so who knows?" Indeed, a few days after Sklar's remarks, the Federal Reserve permitted Morgan Stanley and Goldman Sachs to convert into bank holding companies.

"Ultimately things will turn around," Sklar added. "A month ago, our clients would have said that things would pick up by the fourth quarter of this year or the first quarter of next year. With what has happened with Merrill and Lehman, I don't know if it's going to turn around that quickly."

Facing the Pricing Problem

The latest chapter of the credit crunch meant that major private equity firms, with their hunger for debt capital, could not borrow. As a result, the multi-billion transactions have started to dry up.

"You have to close the deals that are pending - and higher stock prices are helpful - but an M&A market first needs to re-emerge in order to complete new deals," said Steven Davidoff, assistant professor of law at the University of Connecticut. "Right now, I think it's going to be a dry fall for M&A."

At the worst of the market crisis, major M&A faced a critical problem caused by the savage ups and downs of the stock market - the inability to price potential acquisitions or sales of corporate assets. "I've seen lots of swings and lots of market cycles





George Nemphos, managing partner, Duane Morris; Louis Bevilacqua, head of the M&A and securities group, Cadwalader, Wickersham & Taft

ket deals (now defined as deals as big as \$1 billion) continued, albeit cautiously.

“Good, intelligent deals get done. If the economic matrix works, you are going to get it done,” said George Nemphos, managing partner of the Baltimore office of Duane Morris. “We had one earlier this year for which banks were bidding to provide the financing. That was one private equity fund-sponsored company selling to another private equity fund-sponsored company.”



Seward & Kissel's Sklar echoed that assessment. “You can't get debt anywhere, so a lot of the traditional type of M&A activity has dried up,” he said. “The Blackstones of the world and the KKR's can't get financing, but the funny thing is it really hasn't affected our firm. A lot of legal department are very slow right now, while we are extremely busy because we generally are not doing multibillion dollar deals. We look at ourselves as more middle-market.”

Many of Sklar's clients are hedge funds or private equity funds. These days, they are providing Seward & Kissel work by consuming each another.

“Hedge funds are still trying to acquire one another,” Sklar said. “In

in 30 years of doing this, but this one is unique. The markets are reacting with wild gyrations,” said Louis Bevilacqua, head of the M&A and securities group for Cadwalader, Wickersham & Taft, Dealogic's sixth-place M&A law firm. “As a result, even though this all seems to be focused on the financial institutions, it makes it very difficult to price anything.”

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The reason has nothing to do with tough negotiating, complex legalities or in-depth due diligence. Much of the reason is simply human. “Buyers and sellers are always afraid of being embarrassed,” Bevilacqua said. “Typically, when there is a downturn or upturn in the market, the corporate people can figure out how to price the deal. While it's gyrating, however, it's very difficult to figure out because you're going to look wrong one way or the other tomorrow.”

According to one Wall Street M&A expert who asked not to be named, embarrassment or something like it was being felt most acutely by lenders. “Lenders are acting badly in the sense that they are not stepping up,” he said. “They are writing commitments just to keep people in the game, but they're not really committing. So they're walking away from deals, never really stepping up and being a partner in getting it done. They're hoarding their cash because they haven't really addressed all the issues of marking to market the assets they still have that on their balance sheets.”

Debt Sources Dry Up

Whatever the cause, the financial law at work in the M&A market was: the larger the deal, the more credit required to make it work, the lower the chance it could get done; the lesser the deal, the more cash involved, the more likely it was to be completed. That's why, while the big M&A deals tried to survive the deep freeze, mid-mar-

this consolidation of the industry, there are seeding-type arrangements where people are making investments in other hedge funds. That type of activity has stayed steady or increased during the year, whereas the bigger deals - the buyouts - have dried up.”

Some say the funds have money, but nowhere to put it. “There's a lot of money sitting in funds today trying to find a home,” said Nemphos. “These guys will tell you that there are not enough good deals out there for them to want to go off and try to acquire companies.”

Sullivan & Cromwell's Aquila agreed with colleagues who say they don't expect much from the private equity funds or hedge funds, even overseas capital such as sovereign wealth funds. “Private equity transactions require significant debt capital that, at least at the moment, does not appear to be in the system and in all likelihood will not be in the system for some time,” he said. “The key driver on the bigger headline transactions over at least the next two, three or four quarters is likely to be the strategic buyer.”

For now, the worries are real. Chris Talis, senior partner at mid-market acquirer Hedgerow Mergers & Acquisitions, cited concerns over the prospects of a franchise food acquisition in the Jersey City financial district. “We do think that this thing should rebound,” he said. “The question is when.” **it**