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US Dealmaking Falters In Q3 Amid Recession Concerns

By **Chelsea Naso**

Law360 (October 8, 2019, 2:55 PM EDT) -- Recession fears are fueling trepidation in a mergers and acquisitions environment already bruised by global geopolitical headwinds, weighing on a previously resistant U.S. deals market and further pulling down global M&A.

Transaction value globally fell 11.4% year-over-year as of the end of the third quarter of 2019, landing at $2.49 trillion year-to-date, according to the latest quarterly report released by Mergermarket last week.

In the third quarter alone, global transaction value slumped 21.2% compared to the same stretch of 2018, landing at $622.2 billion, with 1,164 fewer deals announced, according to Mergermarket.

That dropoff is tied to a dip in U.S. activity, a region that has until recently withstood all of the uncertainty and challenges to M&A.

U.S. deal value rang in at $262.9 billion for the third quarter of the year, the lowest amount since $254.6 billion in U.S. M&A value was recorded during the first three months of 2016, according to Mergermarket.

"It's down to a level that hasn't been experienced in a couple years," said John Reiss, global head of White & Case LLP's M&A group.

The slowdown in deals getting signed comes after the U.S. proved more resilient to external factors than many had anticipated in the first half of the year. Dealmaking chugged along in spite of stock market volatility, concerns about protectionist policies, and a lack of clarity about the U.K.'s anticipated departure from the European Union, as well as early fears of a recession.

It seems, however, that recession woes have finally permeated boardrooms and private equity firms, creating an environment where acquirers are only pursuing safer or critically important opportunities to avoid inking a deal that doesn't pan out in the event of an economic downturn.

"I think it gets the CEOs really worried that if they enter into an M&A transaction now, the valuation is not going to hold up when the recession comes and they are going to be punished in the market for overpaying for the asset," said Jackie Liu, co-chair of Morrison & Foerster's global corporate department.

That's not to say dealmaking has stopped or will stop, but that acquirers are being more cautious on what they buy and when.

"People who were really rushing to do deals in the earlier part of the year maybe didn't do that incremental deal or decided just to go a bit more slowly on the incremental deal. But they're not stopping doing deals," said Peter Harwich, a Latham & Watkins LLP partner.

That hesitancy to sign new deals that may be tough to explain to shareholders or investors if an economic recession hits in the near future took root at the beginning of the summer, a typically slower time for M&A.

"You started seeing some uncertainty among big corporates, among strategics, in the May and June timeframe. And of course given the lead time in these types of transactions, if people start pulling back then deals don't show up three to four months later," said Alan Klein, co-head of Simpson Thacher & Bartlett LLP's M&A practice.

"When you hit September, coming out of Labor Day, it felt a little like nobody came back from vacation," Klein said.

Worries about a potential economic downturn were fanned further in August when a so-called yield curve inversion — when the yields of long-term U.S. Treasury notes fall below short-term notes — occurred. An inversion of the yield curve is viewed by financial markets as an indicator of a recession, as one has been recorded before every recession over the last sixty years.

"When things like that happen, people tend naturally to just slow down a bit," Harwich said.

Concerns about a potential recession are just one headwind slowing M&A. During the third quarter, trade tensions between the U.S. and major trade partners like China and Europe continued to rise, and the U.S. also unveiled a more detailed set of plans for its implementation of an overhaul to the Committee on Foreign Investment in the United States.

The trade tensions make it difficult to properly value a target, as even if it is a U.S.-based manufacturer it may purchase key components from other countries. And the changes to CFIUS, which reviews U.S. acquisitions made by foreign buyers for potential national security concerns, could cause an initial wave of uncertainty as companies and financial investors digest the changes.

"The uncertainty we're seeing as a result of the lack of visibility and predictability on what regulations will ultimately come into play in response [to] global geopolitical dynamics," said Elizabeth Donley, a Hogan Lovells LLP partner. "That has a very real impact on looking at transactions, looking at M&A, and evaluating how to navigate regulatory uncertainty from both U.S. and foreign investors' perspectives."

It's also not only the U.S. that is struggling to keep pace with the M&A recorded in 2018. Europe has also taken a hit, with M&A deal value for the first three quarters of 2019 down 29.4% compared to the first nine months of last year, according to Mergermarket.

Activity in Asia is also down 26.5% for the same period, with China and Hong Kong accounting for only 7.8% of global M&A value, the Mergermarket report found.

In terms of U.S. M&A, it's hard to say when activity will ramp back up. Aside from the geopolitical

headwinds and concerns about a potential recession, the U.S. is bracing for a presidential election year with an outcome that as of now is difficult to predict.

That can make it challenging for companies and financial investors to understand what the political leadership and policies of the country will be going forward.

"You're going into an election year with a lot of rhetoric and proposed policies. Potential buyers and sellers are trying to sort through what the White House and Congress will look like in a year and the policies that could follow that makeup. All in all, there is a lot of uncertainty out there, be it economic or political," said Mike Bengtson, chair of Baker Botts LLP's corporate practice.

--Editing by Janice Carter Brown.