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DIVING DEEP INTO THE WORLD OF OFFSHORE TRANSACTIONS

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The offshore transactions landscape in 2015 saw 2,969 deals announced — almost identical to the number of deals in 2014 but accounting for a 56 percent increase in deal value.[1] This article examines in detail the nature of the deals seen in 2015, the possible factors driving up the overall value of these deals and finally, what 2016 may hold.

THE NATURE OF DEALS IN 2015

In 2015 (perhaps unsurprisingly), insurance and financial services sectors continued to dominate the offshore transactions landscape. However, there has also been an emergence of deals in the information and communications sector, which continues to grow. In fact, three of the top five deals in the last quarter of 2015 were in this sector.

In addition, management and institutional buyouts saw some popularity with sums certainly worthy of mention.

There are essentially three core types of acquirer deals in the offshore world:

1. **Minority Stake:** There has been a big surge in popularity in these deals, up 15 percent from 2014. These transactions involve an initial stake in a company being acquired by a private equity firm, or an addition to an existing stake being bought for strategic purposes. With an offshore company involved, timing is not a significant hurdle, regulatory consent (where

required) is relatively painless and efficient, and the certainty of law and structural precedence ensures smooth stakeholder acquisition.

2. **Capital Increases:** These involve companies selling more shares to their own shareholders, rather than third parties, as part of a fundraising. This is the most frequently seen deal type. Familiarity of investor base, aggressive timelines and a cash-rich environment all encourage and facilitate capital increase as a preferred method of funding.

3. **Acquisitions:** The majority of large deals fall within this pillar, with over $250 billion spent on offshore acquisitions alone in 2015. The value of the offshore region as a neutral venue for international deals is highlighted by the fact that just three of the top 10 involved acquisition companies that are based onshore.

With increasing activity, it seems that offshore legislation is striking the right balance between being sufficiently robust, but also able to be understood and applied as well.

In particular, Cayman Islands legislation as to mergers and acquisitions is now widely familiar and accepted. Investors understand the thresholds and a Cayman acquisition is a market standard. Take for instance the well-developed area of dissenting shareholders and accompanying case law. Investors take comfort in this area.

VALUE OF DEALS SOARING

The average deal size in 2015 was $149 million, which is the highest yet recorded, seconded only by the previous high of $99 million set in 2007. The timing of the previous high might be a concerning coincidence for some given the current predictions for the markets. This deal size far surpassed the closest competitor region, North America, with its average of $97 million.

It is no secret that U.S. deal activity was driven by the impact of regulatory changes coupled with the competitive pursuit of size and scale. We saw a return to precrisis figures with deals of more than $1 billion accounting for two-thirds of total value.

The public market appetite has created strong competition for assets and an environment of top valuations has grown, putting pressure on valuations and causing leverage levels to rise, with purchase multiples following suit.

PE ACTIVITY AND DRY POWDER LEVELS

Private equity activity has long been a significant feature of the offshore M&A landscape. With a limited availability of asset classes in which to invest and gain exposure and successive years of high levels of distributions to limited partners (LPs), general partners (GPs) are looking for new ways to spend.

At the midyear mark, there were projections of a liquidity rush as GPs cashed in on investments as a result of maturing funds with exit requirements to meet.

According to the latest data from Preqin,[2] total dry powder levels are at a record high, currently over $1.3 trillion, as the pace of investment has lagged fund-raising activity.

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Bain's Global PE Report 2016[3] reports that private equity deal-making in 2015 was "an eclectic mix, reflecting the whims of opportunity and timing" with investor appetite best described as robust.

As mentioned above, the availability of funds has stirred up heavy competition among general partners and corporate acquirers in the market, creating bidding battles that ultimately pushed up deal prices. As there is more competition (and shorter time frames provided by banks), investors risked overbidding. However, as optimistic as these figures appear, this volatile environment and attitude have many speculating that the climate is actually more frothy than it appears and this drive in values might not appear in near-future figures.

Corporate acquirers have been equally active. The benefit of their investment-grade credit ratings assisting their financing opportunities with lower-cost debt created financial strength and allowed them to bid higher (and accept lower rates of return than PE funds) on the assets they so eagerly wish to acquire.

With GPs and corporations out shopping in the same markets, each with their own unique set of favorable factors, the competitive pressure on topping asset valuations mentioned earlier seemed to grow. GPs are keen to find ways to put dry powder to work and looked for different ways to get around the increased competition. Bearing in mind the factor of high multiples and concerned and increasingly conservative lenders, it seems that traditional approaches to investing still excel.

According to Preqin, while the industrials sector dominated private equity-backed buyout deals in 2015, it was the IT sector where the most significant sums were spent — representing 34 percent of the total aggregate value of PE deals during the year.[4]

CONSIDERATIONS FOR 2016

While 2015 was undoubtedly a successful and record-breaking year, thanks largely to healthy market conditions, cash-liquid investors and managers, and confident investors, 2016 has started out cautious with much "watch and see" commentary. It is very difficult to identify exactly what factors will come into play, especially in the context of macroeconomics, and we are in an uncertain place in terms of outlook.

With respect to sectors, there is much speculation that the low cost of energy in the U.S. has many looking for opportunities in manufacturing, while technology and health care are expected to see an increase in valuations.

There is certainly no shortage of factors to consider and significant challenges face the market, including this year's unpredictable U.S. presidential elections, continued discussion surrounding China's apparent economic slowdown, economic and social instability in the Eurozone and the EU generally, including the U.K. referendum on EU membership, and the plunge of oil prices. Much remains to be seen on whether some or any of these factors will sedate the market or cause market players to apply any brakes to their more aggressive investment or acquisition tactics.

There seems to be a lowering of expectations among private equity fund managers, especially in the North American market when compared to their European counterparts. Ironically, what seemed to drive up deals in 2015 (pricing pressure and expectations) might be what causes the slower pace in 2016. Investors are concerned with the misalignment between buyers and sellers regarding price expectations. This is coupled with a growing deterioration in credit conditions potentially causing banks to scale back in stock and debt underwriting.

As suggested in Bain's report, "facing sky-high acquisition prices, increased market volatility and stiffening economic headwinds, GPs know that the prudent course is to wait for deal multiples to ease." Whether such advice is heeded, with the challenge of intense competition and the search for emerging deals and market, remains to be seen.

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With the end of the first quarter of 2016 on us, latest reports indicate as much as a 25 percent fall in global merger activity from the previous year's first quarter, and global initial public offerings dropping to their lowest level in years. However, after this choppy start particularly in M&A we have started what is hopefully a progressively steady upturn and we remain optimistic that it will at least remain stable. The offshore markets continue to see large deal activity and hopefully there will be equally exciting results to report next year.

[1] Appleby Offshore-I Report, 2015 Annual Review

[2] Preqin Private Equity Online platform, accessed March 2016

[3] Bain & Co. Global Private Equity Report, 2016

[4] Preqin, 2015 Private Equity-Backed Buyout Deals and Exits

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