



Preserving deal objectives while navigating an antitrust review



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Executive summary

Successful executives understand that closing a deal in a concentrated market can be highly complex. The added complication in these deals is their potential to receive an additional antitrust inquiry for information called a “second request.” In the United States, this type of inquiry leads to an altered deal more than 80% of the time.¹ This article addresses several key steps C-suite executives can take when impacted by this situation:

- ▶ Understand the regulations and uncertainty inherent in the request process through preemptive analysis to identify key risks
- ▶ Understand the challenges and work involved in a second request for information
- ▶ Employ leading practices to preserve deal objectives

Increased market concentration

Market consolidation is accelerating in several industries, and executives are increasingly using M&A to drive growth while seeking to maintain competitiveness in the age of digital disruption.

In fact, 75% of industries have experienced an increase in market consolidations over the past two decades.² For example, American consumers now have two major choices for pharmacies, four choices for major (non-regional) airlines and four major cell phone carriers.

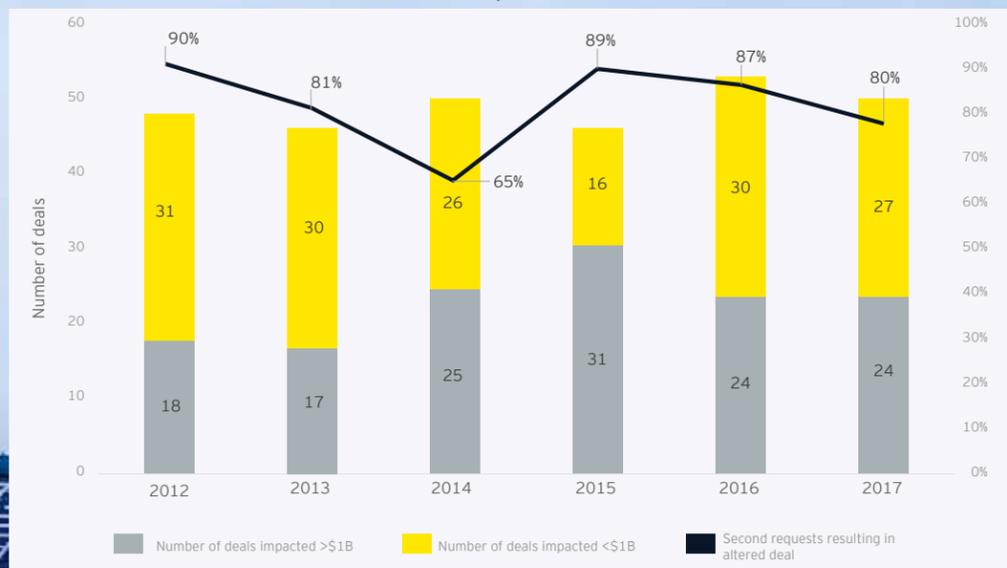
In this era of megadeals, executives looking to increase market share through M&A should understand how a transaction may be viewed by regulators. In the United States, transactions with a value exceeding \$90m must be reported to regulatory authorities for a 30-day review process. If the initial review reveals that the deal could have competitiveness concerns, the agencies may

extend the review through a second request, which can be challenging to navigate if business leaders are not prepared. In some cases, deals have been delayed or abandoned, while others proceeded with a changed deal perimeter and mandatory divestitures.

More than 10% of large deals, those valued at \$1b or above, received a second request in 2017, and the impact of such a request can have implications for a company’s deal strategy. Over the past few years, more than 80% of second requests have resulted in an altered deal. In some cases, deals have been abandoned, while others proceeded with a changed deal perimeter.

Managing these challenges effectively can be the difference between success and failure for many executives.

Greater than 80% of second requests result in an altered deal



¹ HSR Annual Reports 2012-2017: https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014_fy_2017_hsr_report_c.pdf
² Gustavo Grullon, Yelena Larkin and Roni Michaely, “Are US Industries Becoming More Concentrated?” <https://pdfs.semanticscholar.org/138f/249c43bfec315227a242b305b9764d57a0af.pdf>

We recommend two steps before even evaluating a deal, in anticipation of regulatory review. First, know what can trigger an inquiry and second, understand how the deal fits with the larger portfolio.

Understand what regulators evaluate

US regulators generally consider five types of evidence when evaluating a merger (as per the Federal Trade Commission (FTC)/Department of Justice (DOJ) Horizontal Merger Guidelines).³ These factors may determine if an inquiry is made:

1. Actual effects observed in consummated mergers
2. Direct comparisons based on experience
3. Market share and concentration
4. Substantial head-to-head competition
5. Disruptive role of a merging party

Periodically review your portfolio with an antitrust lens

Assets identified for potential divestitures or business segments planning a potential acquisition can undergo an antitrust review. Leaders can seek guidance from antitrust specialists to gauge the level of market competitiveness for each asset and business and for each potential partner.

Deals with potential antitrust issues can be assessed for the operational complexity of divesting the asset – specifically the level of entanglement and effort needed to exit certain markets.

If complexities exist, sellers can (a) preemptively pursue “accelerator” projects, such as proactively divesting certain jurisdictions to facilitate smooth separation of partial assets, or (b) plan to retain select assets within the company to optimize the value of the rest of the assets.

Drivers of current antitrust environment		M&A leaders may need to be prepared for a potential second request	
75%	of US industries have experienced an increase in concentration levels over the last two decades ⁴	\$90m	In the US, all transactions with a value exceeding \$90m must be reported to regulatory authorities for a 30-day review process. ⁷
Higher profit margins	Firms in industries with the largest increases in product market concentration have enjoyed higher profit margins, as well as positive abnormal stock return. ⁵	51	deals totaling over \$100b received a second request from the US FTC in 2017. ⁸
50%	reduction in publicly traded firms in the United States over the last decade. ⁶	80%	of second requests resulted in a changed, litigated or abandoned deal in 2017. ⁹
Growth through M&A	With high pressure for companies to grow faster than ever, many have found M&A to be the best option for growth and profit maximization.		

³ FTC/DOJ Horizontal Merger Guidelines: <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010>
⁴ Gustavo Grullon, Yelena Larkin and Roni Michaely, “Are US Industries Becoming More Concentrated?” <https://pdfs.semanticscholar.org/138f/249c43bfec315227a242b305b9764d57a0af.pdf>
⁵ Ibid
⁶ Bloomberg: <https://www.bloomberg.com/opinion/articles/2018-04-09/where-have-all-the-u-s-public-companies-gone3> Initial public offerings updated statistics, Rxxtter January 2018
⁷ HSR Annual Report 2017: https://www.ftc.gov/system/files/documents/reports/federal-trade-commission-bureau-competition-department-justice-antitrust-division-hart-scott-rodino/p110014_fy_2017_hsr_report_c.pdf
⁸ Ibid
⁹ Ibid

What impacts can be expected when a deal receives an inquiry

Once a deal is signed, parties must go through the Hart-Scott-Rodino (HSR) filing process with US regulators, and the review outcome can go a myriad of ways (Table 1). In approximately 90% of deals, the transaction is cleared after the initial 30-day review process. However, when a transaction is flagged for a “second request,” the buyer and seller may be faced with significant challenges:

- 1 Addressing a regulator inquiry can delay your deal timeline by up to 18 months (Table 2), as companies:
 - ▶ **Address the data request from the second request and follow up (data collection).** The volume of requests and iterative follow-ups can slow the deal, even with some preparation. As part of this review process, management teams and advisors could be subpoenaed for interviews and subject to e-discovery, where their emails and hard drives may be required to be preserved and scanned as part of the discovery process.
 - ▶ **Assess countries in the deal.** Regulators in other jurisdictions may be more likely to issue an inquiry on the deal.
 - ▶ **Analyze the government's market definition.** Detailed analysis to understand the regulator's market definition may be needed in order to develop an informed response or prepare for a possible divestiture. Back and forth with regulators on any of these processes can significantly prolong the timeline by up to 18 months.
 - ▶ **Certify compliance.** Once all data requests have been fulfilled, the management team can certify compliance and restart the 30-day review process¹⁰. At this point, the parties can negotiate a remedy or the clock can simply expire. If, however, the regulators don't agree, they can file an injunction to block the deal. Thus, this can be a risky and expensive maneuver that may need to be chosen carefully.
- 2 Executing a mandated divestiture may lead to “cherry-picking” assets or product lines, which can create various complexities for the new business. According to an FTC study, businesses partially divested in response to regulator scrutiny significantly underperformed businesses divested as a whole, post separation¹¹.
- 3 Potential buyers can see mandated divestitures as “a fire sale,” in other words, an opportunity to buy the assets at a low price, so sellers may need to settle for a less-than-optimal bid to close the broader deal.
- 4 There is significant stakeholder uncertainty. Key employees who are aware of the potential divestiture may leave or become disengaged. Customers and suppliers may be less willing to negotiate until they find out what happens with the deal.

The process to comply with antitrust regulations can impact your deal timeline

Table 1: The HSR filing process and antitrust review can go a myriad of ways¹²

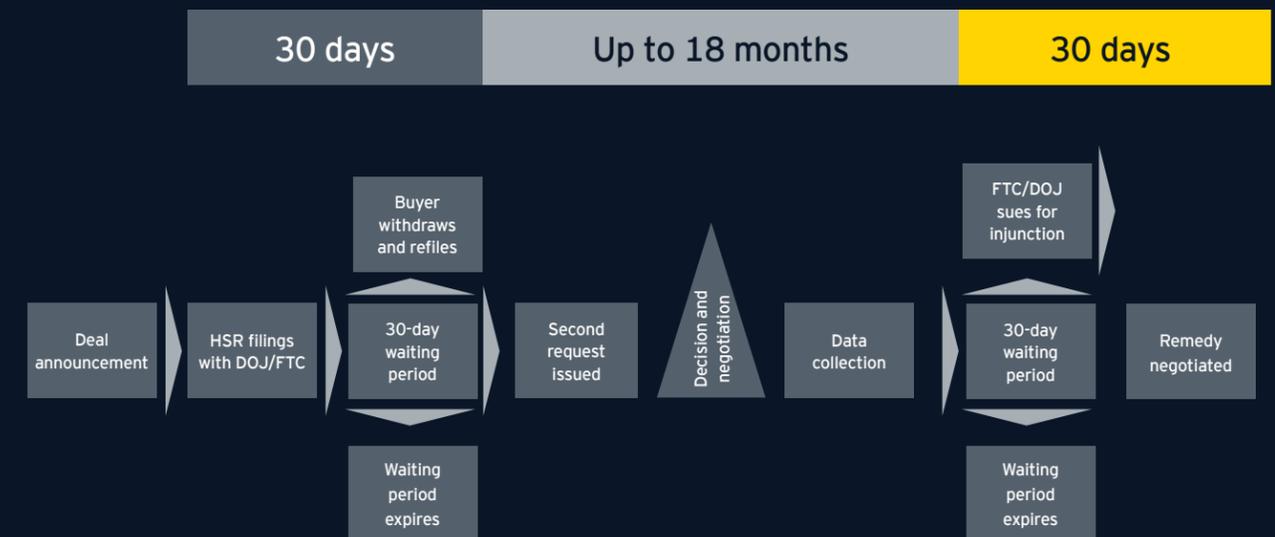


Table 2: Examples of how antitrust scrutiny from regulators can draw out the sign-to-close process significantly

Typical sign-to-close timing

Typical sign-to-close: 3-9 months

Sign-to-close timing of deals involving antitrust scrutiny

Illustrative merger of packaging suppliers: 17 months

Illustrative railroad industry merger: 18 months

¹⁰ FTC Premerger Notification and the Merger Review Process: <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/premerger-notification-merger-review>
¹¹ The FTC's Merger Remedies 2006-2012: https://www.ftc.gov/system/files/documents/reports/ftcs-merger-remedies-2006-2012-report-bureaus-competition-economics/p143100_ftc_merger_remedies_2006-2012.pdf

¹² FTC Premerger Notification and the Merger Review Process: <https://www.ftc.gov/tips-advice/competition-guidance/guide-antitrust-laws/mergers/premerger-notification-merger-review>

Leading practices to maintain deal objectives in an antitrust environment

If business leaders find themselves in a deal affected by antitrust scrutiny, they may wish to consider some key steps to maintain the attractiveness of the deal.

Align with the antitrust regulator on the correct market definition and the scope of the second request

It is important for business leaders to seek out an independent analysis of how the potential deal could impact competition. They may wish to then use that analysis to present an informed position to regulators. Working with experienced advisors to liaise with regulators can significantly decrease the amount of data requested and work needed to comply with the second request.

Tailor the approach to maintain the timeline and increase agility

Dynamic scenario planning at the point of the deal is essential, as it can be difficult to predict the final outcome of the FTC review and what assets will be affected. Business leaders can use information from the second request to create several potential scenarios. In anticipation of multiple mandated asset sales, multiple data rooms can be pre-populated with information corresponding to each potential scenario. This way, when the remedy is finally agreed upon, the company may be prepared to enter into a process to sell the affected asset immediately.

Initiate dynamic scenario planning at the operational execution stage

Since it is typically unclear which assets may be affected and what type of buyer could acquire these assets, organizations should plan the separation across multiple scenarios. They may wish to factor in the unique complexities of each asset and buyer pool, so that the organization is ready to execute as soon as executives hear the remediation plan. This includes preparing or refining the value story for potential divestitures to increase sale proceeds. Tools such as EY Capital Edge can assist with this

dynamic planning.

Establish clear expectations and channels of communication with employees

Antitrust scrutiny can create uncertainty in the workforce. It is therefore important to regularly communicate with employees. A variety of tools, including executive town halls, employee portals and one-on-one discussions, can be deployed to communicate with employees. Additionally, focus groups and employee surveys can assess the impact. To the extent possible, employees may feel that they understand the review process and the plans for the organization's future state. Key employees can be identified for a formal retention program, contingent on meeting important business objectives. Employee retention programs are often used in transactions to deal with uncertainty, and few transactions create as much uncertainty as one impacted by regulatory review.

Establish clear expectations and channels of communication with customers and suppliers

A drawn-out regulatory review also creates significant uncertainty with key customers and suppliers. As with employees, frequent communication can help to remove the perception of risk with customers and suppliers. A detailed communication strategy may be important to include senior leadership involvement with frequent customer and supplier touch points. Customer and supplier risk models may determine particularly high-risk suppliers and customers. A risk reduction strategy may then include commercial and contractual protections to reduce risk.

Conclusion – know the pain points, pick your battles and prioritize accordingly

Preemptive efforts to minimize the antitrust impact on deals and planning for possible adjustments resulting from regulatory reviews can become standard practice for M&A teams. The key to navigate through uncertainty is for senior executives to recognize the importance of involving the right internal and external resources at the appropriate times to assess the benefits and risks of the contemplated transaction.

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