



THE FUTURE OF M&A AND ACTIVISM: MORROW SODALI Q&A WITH DAVID HELENIAK

Harry van Dyke, Morrow Sodali's Executive Vice Chairman, spoke with David Heleniak, former Vice Chairman of Morgan Stanley as well as former Senior Partner and M&A Head at Shearman & Sterling, on the state of M&A and Activism today.

Harry van Dyke

Given your extensive experience in the world of M&A and your having seen the market go through several cycles, I expect you'll have a very interesting perspective on what's going on in the M&A market today. Clearly M&A volume declined substantially in the second quarter and it has not really recovered. We're curious when you think things might pick up and what might drive that recovery, assuming it's on the way.

David Heleniak

First of all, COVID-19 is a cataclysmic event with which no one has previous experience. When something like that occurs, intelligent people hit the pause button and analyze how they should respond. That's really what's happened here, and that's why M&A deals not already announced are not being launched at the moment.

While most of the short term effects on the economy are becoming relatively clear, the longer term effects are still a bit murky, and for much of M&A dealmaking a comfortable view of longer term is important. So the discussions which had begun prior to the pandemic but had not led to any deal have been put on hold until things are clear. Many deals that had been announced before the outbreak have been either restructured or abandoned.

But back to the question of when transactions might pick up again and why. In the near term companies that were severely hit as a result of the pandemic will be either selling their assets or possibly finding merger opportunities, and it's entirely possible that activist shareholders might push aggressively for those kinds of actions. That means now is a time when companies need to make sure they're monitoring who their shareholders are and what their positions on such things are.

Healthy companies are likely to take a longer time to get there. They're probably going to be trying to strengthen their balance sheets while they go about actions that are dictated by things like restructurings in supply lines, such as moving to more conservative inventory management and other changes that are likely to reflect the new normal.

As a result, I don't expect a resumption of aggressive M&A activity until after vaccines are both in place and have been widely administered, which could happen in 2021. But it could also be even longer before companies are really confident. I think it's important to remember a recent quote by Nobel Laureate Paul Krugman, who said that anyone who tells you he knows why short term market movements occur proves he has no idea what he's talking about.

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So maybe it's a combination of lack of confidence on the part of CEOs and lack of knowledge about where things are heading?

I think the word confidence may be used too easily in this context. If you have a good company and good management, they maintain their confidence throughout, but part of being good is being fairly confident in what's about to happen.

There are certainly some areas in which you might see short term M&A activity because of how hard hit the businesses are. Anything in the hospitality area relating to long distance tourism could be subject to more immediate activity, not because people know whether tourism is going to rebound to its previous levels three years from now, but really because the companies just have to do a deal because they're otherwise going belly up.

It sounds as if you think the M&A that will happen in the near term will be more crisis driven rather than strategically driven.

Yes, I do.

The last collapse in the M&A market was the 2008 financial crisis and activity took several years to recover. Today is a very different situation, of course, but do you see parallels between the two?

I really think it's completely different. The financial crisis arose from too little attention to risk. Financing was not anywhere near as easy to obtain for big transactions in the immediate post-crisis period. Banks were less willing to finance transactions, and that just took a while to get past.

This situation is not financing driven. It's not isolated to a few industries. As I said at the outset, it's something nobody's experienced and therefore it takes time to see how people and how markets will respond. Nobody, for example, could comfortably tell you today what percentage of Manhattan or other downtown real estate will be fully occupied once the pandemic is behind us. As a result, the real estate industry is one that's very uncertain at the moment. It's just going to take time to figure all of that out. It's not a simple "when will the money be available again?"

I suppose you would argue there really aren't any parallels between the current crisis and any of the previous ones, whether it was the dotcom bust or even further back, the real estate collapse in '87, or...

What I always say about that is that I made a remarkable discovery after years and years in the capital markets, which is that people whose activities are closely tied to the capital markets, for example M&A practitioners, fail to understand one basic fact that we were taught in college, namely that financial markets are cyclical. Whenever things are going up, people think they will always go up, and when they go down, they think the end is nigh. Therefore in both the tech bubble burst and in '87 and earlier downturns, people fear dire consequences, but shortly thereafter, they've realized it didn't mean that, it just took time for the economy to return to a stronger state, creating more certainty and therefore more attractive growth opportunities.

I imagine you noticed that there was a brief but significant wave of companies instituting short term poison pills in the spring, particularly in the depths of the market collapse. Do you think they're simply throwing up defenses against opportunists?

Yes, but poison pills have never been well understood by those who aren't constantly dealing with them. Poison pills are not really

defense mechanisms. What they are is something that buys time; they've never actually prevented a takeover. A pill is something that gives you time if there are other opportunities to pursue in the short term, which is why we saw the increase in pills in March and early April. They can stop an acquirer from building a position for some period of time, and I think that's why they were adopted -- so companies wouldn't find themselves in a position too quickly where activists were dictating the course of the corporation. It was a relatively smart thing to do for companies that found dramatic share purchases happening when the market was absolutely shattered for that short period.

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There was quite a bit of anti-M&A activism last year, before things fell apart with COVID-19, with investors on both sides of deals agitating for changes in the terms of transactions, particularly the shareholders of the target looking for more. Do you think there will be any change in how activist shareholders might look at M&A transactions?

It may be an old school view, but in the old days this was called "greenmail." That whole activity has been reenergized and given a certain amount of respect by referring to it as "activism." Carl Icahn is alive and well. Some activists acquired more clout by buying during March and April, as we just talked about. They can be expected to use it and I think others will as well.

The activist market has changed significantly. That's something that's very important for companies to pay very close attention to because activists are not purely the greenmailer types of the Carl Icahn mold, they now include many institutional investors who align themselves with particular activists in particular situations. They will be looking at M&A possibilities unless they see some other short term change that they consider to be more important.

The agendas of institutional holders and arguably of some of the activists have also changed. ESG is now something that is more prominent and instead of saying "we have to sell the company," it can lead to saying "we need to replace the CEO," or "the board is filled with people who've been there for 28 years, time to put in new blood." For example, they have a much different approach to the oil and gas industry, which has been pretty hard hit by all of this, and you now have environmental activism as opposed to M&A activism.

It sounds as if you think the activist shareholders are not necessarily going to agitate for more M&A but they will continue to advocate for a broader range of things than they used to pursue.

Correct. I think institutional holders may also be moved to it by an activist starting the process, but I don't think they're likely to become aggressive pushers of deals.

One thing I didn't mention is institutional holders in the short term are highly unlikely to push for some of the things that characterized activism before this, namely special dividends and stock buybacks, because they're going to have seen in the crisis that maintaining capital is not always a bad thing. There's undoubtedly

some limit to how much they think is too much, but that's something that they'll want to reassess.

What are you hearing from your former colleagues, both investment bankers and lawyers? Where do they think this is all headed, or is it still all completely uncertain?

I think their views are pretty much the same as mine. I definitely think M&A will come back at some point for sure, but it's still too early to tell. Worst of all, as you monitor U.S. public opinion for example, you're constantly greeted with things that just simply don't make any sense. So, it's very hard to predict.



DAVID HELENIAK

David Heleniak was the Vice Chairman, a Managing Director and member of the management committee at Morgan Stanley, which he joined in 2005 and retired from in 2018. At Morgan Stanley, his mandate encompassed work at the senior-most levels with clients, regulators and other key constituencies around the world, as well as with the firm's senior management team on issues of policy and direction, external and government affairs, and legal and regulatory matters.

Prior to joining Morgan Stanley, David spent 29 years at Shearman & Sterling where he became the Senior Partner (CEO) in 2001 and where he headed its Mergers & Acquisitions Group for more than ten years. From 1981 to 1984, he led the firm's Hong Kong office where he represented, among others, China National Coal Development Corporation in the first major joint venture completed by a Chinese entity with a US partner. From 1977 to 1979, he served the United States government in the Department of the Treasury, first as Executive Assistant to the Deputy Secretary and subsequently as Assistant General Counsel (Domestic Finance).

Among his numerous philanthropic and civic affiliations, David was a member of the boards of directors of the New York City Partnership, the New York City Ballet (where he is a past President), The Legal Aid Society, the Japan Society (past Chairman), and the Council for the United States and Italy (past Chairman), as well as a member of the Council on Foreign Relations.

David earned a B.A. from the University of Michigan, an M.Sc. from the London School of Economics, and a J.D. from Columbia Law School.



HARRY VAN DYKE

Harry van Dyke has more than 30 years of experience in a range of roles in investment banking. He is the former CEO and founder of Teneo Capital, an investment banking boutique providing financial advisory services to corporations, family offices and private equity firms on a global basis. Prior to Teneo, Harry was a Managing Director and Group Head in Investment Banking at Bank of America, where he established, built and ran a business development effort while concurrently overseeing two M&A businesses – Corporate Divestitures and Middle Market M&A. Previously, Harry spent 22 years with Morgan Stanley, most recently as a Managing Director and Group Head in Investment Banking. During his tenure with the firm, he launched and ran both the Latin America and Asia Pacific M&A franchises, and lived in both London and Hong Kong.

Harry holds a BA from Yale University in Economics and in Engineering & Applied Science, as well as an MBA with honors from the Harvard Business School.