

Corporate Finance Advisory Trending Topics

A 2017 compendium

The corporate finance landscape of 2017 will likely be remembered for its records and its reform. As we write this in December, U.S. equity indices flirt with all-time highs, volatility across asset classes remains near lows not seen in decades, and U.S. legislators appear on the brink of passing tax legislation likely to reshape how individuals and firms think about some of the most fundamental aspects of finance.

With this backdrop, in September J.P. Morgan’s Corporate Finance Advisory team commenced a periodic summary of “Trending Topics,” with the goal of identifying specific themes and trends across corporate strategy and M&A, capital markets, capital structure/allocation, market intelligence, and other accounting or regulatory subject matter. This collection of materials reflects the culmination of that work and serves as a reference for J.P. Morgan’s clients.

In 2018, we plan to continue to distribute “Trending Topics” summaries on a regular basis. Please reach out to your J.P. Morgan banker to ensure these are received. We hope you find them both insightful and interesting.

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SEPTEMBER 22, 2017

Revisiting real estate monetization opportunities

Announcements for separations in the Real Estate space have been active in 2017. Meanwhile, traditional corporates continue to experience activist pressure, which includes prospective monetization of real estate. Could it be time to revisit real estate monetization opportunities? Notable recent precedents:

- Wyndham Worldwide separation into franchise-fee hotel versus timeshare
- Vornado REIT's regional spin-off of JBG Smith (DC versus NY)
- Spirit Realty REIT leveraged spin-off of a new REIT that includes a combination of higher-risk assets plus an asset backed securitization

KEY TAKEAWAYS

- Real estate equity investor base is ripe to participate in value-enhancing structures
- Opportunities may exist even for traditional corporates otherwise subject to tax friction

OCTOBER 20, 2017

If SPACs aren't already part of your lexicon... they should be

"SPACs" have captured the attention of the capital markets and have become more reliable bidders in acquisitions than in past years. SPACs, or Special Purpose Acquisition Companies, are "blank check" companies set up by established management teams that raise public capital (via IPO of shares and warrants) to fund an acquisition within a specified time frame (usually two years). In the event the public investors don't find a prospective acquisition attractive, they can "put" their shares back for par. SPACs remain noteworthy given:

- Improvements in basic SPAC structures allowing for more committed capital have made them more attractive acquisition vehicles
 - Increased use of committed forward purchase agreements to attract co-investors and bolster buying power
- SPACs have been active acquirers across *all* sectors
 - U.S.-listed SPACs are also increasingly looking at foreign-domiciled targets
- Sponsorship from well-known PE firms and CEOs has created an uptick in new marquee SPACs (e.g., ones backed by Blackstone, Carlyle, TPG, and Riverstone)
- In 2017 year-to-date, SPACs comprised 21% of the IPO market... compared to 2% in 2013

KEY TAKEAWAYS

- SPACs continue to be a major participant in both private company M&A and reverse IPOs
 - Marquee SPACs are bringing more committed capital to the table
- J.P. Morgan has led three SPAC IPOs this year, with a fourth currently filed, and maintains both structuring and market expertise in the space

NOVEMBER 3, 2017

Markets-based hedging for expanded M&A opportunities and more efficient risk management

In M&A or spin transactions, credit risks frequently need to be managed as there may be residual exposures that reside with one party following the transaction. These solutions can be funded (monetization) or unfunded (credit hedge), and can be executed in size versus traditional CDS, insurance and factoring. Further, these markets-based risk management products can also enable buyers who otherwise would not have been eligible bidders in M&A situations. For example:

- **Hedge seller financing in M&A**
 - J.P. Morgan advised an investment grade European energy company on a business divestiture to a high yield buyer
 - A prospective buyer submitted a bid which included a sizeable vendor loan note from the seller
 - To accept this attractive bid, the seller was required to hedge the credit risk of the buyer
 - Although CDS does not trade at the specific buyer entity, the buyer is a well-known high yield issuer and creating a tailored hedge was achievable
 - J.P. Morgan was able to provide a financial guarantee, which did not require mark-to-market accounting for the seller
- **Hedge residual credit exposures outstanding post spin-off**
 - In the context of a spin-off, a company needed to hedge residual parent guarantees made to its SpinCo
 - The company was well known in the market and there was enough public information available to analyze SpinCo credit risk
 - Hence, a market-based solution was achievable whereby J.P. Morgan offered tailored credit protection to the company, despite lack of publicly available CDS at SpinCo

KEY TAKEAWAYS

- In M&A, sellers may be able to broaden the pool of buyers to include those that could benefit from seller-financing, knowing that risk could be efficiently hedged
 - Attractive buyer bids may be more competitive if their credit risk can be appropriately hedged
- Markets-based solutions can also be used to manage new, oversized, or residual credit risks created via either M&A or spin-off activities

NOVEMBER 17, 2017

Ratings evaluation and assessment services can be useful in an LBO context

The Ratings Evaluation and Assessment Services (RES/RAS) provided by Moody's, S&P and Fitch allow firms to get feedback on multiple capital structure scenarios from ratings analysts on a hypothetical and confidential basis.

- RES/RAS services can be used in the context of M&A, spins or other transformational events to optimize rating outcomes and eliminate rating risk
- Further, RES/RAS can also be utilized in the context of an LBO to maximize debt capacity while avoiding unfavorable rating outcomes, typically below B2/B
 - Sellers can engage the agencies on various debt scenarios prior to or during the sell-side process
 - Valuable in sponsor-to-sponsor sales where leverage may already be high and ratings in the single B category
 - Can help in identifying a “leverageable” EBITDA in situations where there are many EBITDA add-backs

KEY TAKEAWAY

- RES/RAS can help buyers and financing partners get comfortable with the underwriting risk typically associated with LBOs while maximizing value for the sellers

NOVEMBER 17, 2017

Strategic monetization alternatives exist for firms with large cross-holdings

Firms with cross-holdings (direct and liquid ownership interests in other public firms) are often challenged with how to monetize these holdings. Firms with large cross-holdings usually acquire them from acquisition consideration or a direct investment in the stock of another company that has grown substantially

- Several strategic alternatives are available for firms to monetize these stakes, but are often accompanied by potential pitfalls:
 - Straight sale of the stake is often subject to tax leakage depending on taxable gain on the shares
 - A margin loan against the stake is subject to interest expense and margin calls
 - However, a margin loan can allow the company to retain the dividend and voting rights associated with the shares
- J.P. Morgan recently developed and executed a bespoke, markets-based solution that enables a company with a significant cross-holding to:
 - Sell a substantial portion of their holdings over time at a committed premium to the average market price
 - Obtain financing via margin loan against 100% of their position, and retain dividend/voting rights
 - Not utilize bank capacity

KEY TAKEAWAYS

- J.P. Morgan's bespoke structure can be an effective mechanism for Corporates or Sponsors considering monetizing/borrowing against their equity holdings
- Solutions like these may become even more relevant given forthcoming accounting changes, beginning January 1, 2018, that will require public equity investments where no significant influence is present (usually less than 20%) to be marked to market

NOVEMBER 17, 2017

Unlocking value with revised Japanese tax-free spin-off rules

The Japanese Ministry of Economy, Trade and Industry enacted an amendment for tax-free spin-off transactions starting April 1, 2017. The scope of transactions qualifying as tax free has expanded to include certain types of spin-offs, which historically have been considered taxable transactions

- Under the current Japanese corporate tax law, a tax-free demerger occurs only if certain requirements are met, for example, no change in ownership relationship for demerging/demerged companies and continuity of merged businesses; which limits the number of spin-off transactions
- Under the newer, revised spin-off tax amendments, two additional types of spin-off transactions are now considered tax free:
 - Vertical corporate split: A parent transfers some businesses to a newly incorporated, unrelated company
 - In-kind distribution of shares in subsidiary: The parent distributes the shares of a wholly owned subsidiary to its shareholders
- In order to qualify, there are a series of tests to pass, such as control, asset, employee retention, business continuity and directors test

KEY TAKEAWAYS

- Japanese firms can simplify their corporate structure and unlock value through a spin-off of a subsidiary
- Global M&A with Japanese assets may become more active, if assets can be available at reasonable valuations through tax-free spin-offs

DECEMBER 1, 2017

“Flowback” as a consideration in cross-border transactions

Flowback occurs when investors sell acquirer shares received in a merger, as a result of either an inability or lack of desire to hold shares of the combined company, and may result in a technical short-term impact on share price. Flowback is particularly acute in the context of cross-border mergers because domestic investors may be unfamiliar with the foreign corporation and/or may not be allowed to hold foreign shares.

Recent themes:

- Flowback remains a transitory phenomenon, and is less relevant than fundamental analysis and rationale of a transaction
- Targets are increasingly willing to accept foreign stock as consideration, as seen in larger cross-border transactions
- Flowback from index trackers can be mitigated
 - Demand from funds tracking an index that includes the acquirer can help to offset supply
 - Notably, Technip and FMC's cross-border Merger of Equals became the first company to become a member of the S&P 500 and another country's main index (The CAC)

KEY TAKEAWAYS

- Flowback is an important consideration for cross-border deals, but is transitory in nature and can be mitigated... though not fully eliminated
 - Common options to mitigate flowback include (i) non-deal road shows, (ii) a liquid, sponsored ADR, and (iii) share repurchase programs
- Transitory price pressure from flowback should be weighed against the benefit of creating liquidity for the acquirer's shares in a new market
 - Precedents show that the acquirer can maintain the vast majority of liquidity that had existed for the Target's shares in its home market

SEPTEMBER 8, 2017

Unintended consequences in separation transactions

Following its recent spin-off of Brighthouse, MetLife had to launch a consent solicitation to four classes of subordinated bondholders to allow it to continue to pay its common dividends:

- After the spin transaction closes, MetLife's GAAP metrics will be inherently lower
- Under the terms of certain MetLife subordinated hybrid bonds:
 - Coupons would be mandatorily deferred upon failing GAAP-based tests
 - MetLife would not be able to pay common dividends again until GAAP tests were passed and hybrid coupons were paid
- A 25bp consent offer was met with bondholder opposition, however a revised 100bp consent offer subsequently received ~80% approval
 - MetLife will have to pay \$26mm in consent fees to bondholders

KEY TAKEAWAYS

- There are frequently unintended consequences in the context of separation transactions
- Companies should carefully consider implications of any covenants in all possible scenarios, and ensure appropriate protections
- Structuring experts can help to both identify and explore bespoke solutions

OCTOBER 6, 2017

Proactive actions in the context of potential tax reform

Following the release of the September 27 "Unified Framework" on tax reform, firms should rapidly reassess what types of actions make sense to proceed with today, ahead of year-end.

- High-coupon debt liability management, to take advantage of a deduction at 35% today
 - Comcast just announced a \$4bn exchange for mid-5% to 7% coupon ~20-year bonds into ~4% new 30+-year bonds
 - Bonds trading in the \$145 to \$125 price range
 - Similar transactions executed in 2017 by Verizon, Discovery, Lowe's, Masco, Walmart, and Cox
- Issue callable debt to maximize optionality in the event of repatriation
 - Many firms issued a three-year floating rate bond, callable anytime after the first year
 - Only a ~10 basis point premium to a non-callable three-year bond

KEY TAKEAWAYS

- Consider actions that maximize value with little-to-no downside in the event substantive tax reform does not occur
- Given that tax reform may shift to 2018, acting before year-end may be even more beneficial

OCTOBER 6, 2017

New convertible bond structure better allows for future spin/split-offs

J.P. Morgan structured a novel convertible structure for IAC/InterActiveCorp, a media and internet company of consumer brands, such as Match, HomeAdvisor, Investopedia, Vimeo, and Angie's List. Traditionally, debt indentures limit the sale, transfer (including spin), or lease of "all or substantially all" of a firm's assets—a legally vague term that may preclude large separation transactions. However:

- IAC's "exchangeable notes" are the first convertible that allows a firm to complete a spin- or split-off of any size, with "substantially all" of its assets
 - Reverse spins or reverse splits, where the convertible debt travels with the SpinCo/SplitCo, would also be possible
- Proceeds were used to retire outstanding 4.875% senior debt, leaving only the exchangeable notes in the capital structure
- IAC (Ba2/BB) priced \$518mm of a five-year at 0.875% (32.5% conversion premium; a separate call spread was executed to increase the premium to 100%)

KEY TAKEAWAYS

- Separation-friendly structures may be available in the convertible market for select clients, and structuring experts can help to craft bespoke solutions
- Firms most likely to benefit from using this new structure are those with (i) a track record of past and potential future spin/splits and (ii) ability to retire antecedent debt

OCTOBER 20, 2017

To multi-class, or not to multi-class?

For years, institutional investors have campaigned against multi-class shares that concentrate founder/management control. The March 2017 Snap, Inc. IPO, which involved the issuance of only non-voting shares, was the catalyst for the major indices to revise their multi-class criteria this summer. S&P will explicitly exclude multi-class shares structures going forward (existing constituents grandfathered) while Russell will require minimum 5% public voting rights (existing constituents need to comply within five years).

- Switch, a data center operator, raised \$611 million in one of the largest tech IPOs of the year (~\$4.3bn mkt cap; J.P. Morgan-led)
 - The company has three classes of shares, including a Class C which gives founder/CEO ~67% of the voting power
 - Class A shares, issued to the public, will have one vote per share, representing about 5.6% of the voting rights
- As a result, Switch is likely to be included in Russell indices but excluded from S&P indices
- In contrast, Facebook originally approved a plan last year to issue new non-voting Class C shares, to maintain Zuckerberg control
 - However, it withdrew the plans in late September following the S&P criteria change announcement

KEY TAKEAWAYS

- It is possible to have a multi-class share structure and achieve a company's competing objectives
 - MSCI is yet to announce its guidance, which could yet be another important constraint
- For smaller companies, voting control may be more important than multiple index inclusion—at least in the early years

DECEMBER 1, 2017

Preferred equity as an alternative to... equity

Master Limited Partnerships (MLPs) have been actively issuing non-convertible preferred equity, as they look for alternatives to common equity and traditional senior debt. Non-convertible preferred issuance by MLPs has reached \$4bn+ in 2017YTD versus ~\$2bn total across the prior four years. The re-emergence of this product for non-financials, albeit in a niche market, serves as reminder that:

- Non-convertible preferred is sold to fixed income investors at a premium to senior debt
- The rating agencies give these preferreds qualitative benefits and at least 50% common equity treatment in credit ratios
- However, rating agencies will limit these types of instruments allowed in the capital structure
 - NuStar recently breached S&P's limit of 15% of capital, and lost equity credit on all its instruments
 - However, NuStar proceeded with its new preferred issuance, which still received 100% equity credit from Moody's

KEY TAKEAWAYS

- Corporates should reevaluate the benefits of preferred equity, including diversifying their investor base—however, they should be wary of an over-engineered capital structure
- Non-financial issuers of preferred are predominantly REITs and MLPs, both 0% taxpayers...
 - ... a reminder that, for corporates broadly, preferred could be more attractive in a lower tax rate environment as “cheap equity,” versus more expensive senior debt

SEPTEMBER 8, 2017

Disrupt, or be disrupted: Corporate strategies for an increasingly disruptive world

Business disruption is becoming an ever-more relevant topic for management teams and boards, attributable to the increasing pace of technological change across industries. Despite this increasing risk, corporate investment in capex and R&D has actually declined over the last decade. Further, activists remain focused on near-term metrics. Are corporate financial policies failing to adapt to the changing environment? Corporate Finance Advisory has published a new report that highlights¹:

- Disruptors outperform the broader market
- Effective capital allocation and communication strategies can help to maximize long-term value of a disruptive investment
- Firms can reduce risk and highlight value for investors via structural alternatives, including joint ventures, tracking stocks, or separation techniques

SEPTEMBER 22, 2017

Opportunistic repatriation of offshore cash

Synopsys recently announced a plan to repatriate \$775-850mm of their \$1.2bn of overseas cash by **October 31, 2017**. Synopsys is using R&D tax credits to lower the repatriation tax bill by over \$100mm. As of their FQ3 July 31, 2017, they had \$1.3bn in total cash and equivalents.

- One time tax expense (excluded from non-GAAP results) of \$160-180mm expected
- Tax payment, after credits, of \$40-50mm expected to be paid by or before April 30, 2018
- Repatriated cash use of proceeds “*consistent with current capital allocation strategy (funding operations, stock repurchases, acquisitions, and debt repayment)*”...
 - ... though equity analysts have highlighted share repurchase as a possible use of proceeds

KEY TAKEAWAYS

- Technological change is driving a winner-take-all environment, so first-mover advantage is key
- Firms should be bold in their investment decisions, even if markets may not immediately ascribe value

KEY TAKEAWAYS

- Firms should not let the uncertainty of tax reform drive inaction
- Firms exploring options to repatriate cash should consult with tax and structuring experts to focus on ways to minimize tax friction with tax credits

¹ For further reading, please see our report *Disrupt, or be disrupted*, located at <https://www.jpmorgan.com/jpmpdf/1320743784523.pdf>

SEPTEMBER 22, 2017**Moody's gives a 36-month look forward period post-acquisition**

Northrop Grumman's announcement to acquire Orbital ATK this week received a positive reception from Moody's, despite a significant erosion in pro-forma credit metrics. In contrast to the negative reaction expected by S&P, Moody's has given a 36-month ratings look-forward rather than the typical 12-24 months, due to:

- Positive outlook on the Aerospace and Defense sector
- Favorable view of the strategic rationale of combining the businesses and buy-in of planned synergies, integration plan and projected free cash flow generation
- Northrop's commitment of free cash flow for debt paydown and a share repurchase reduction of 66%
- Slightly more relaxed leverage expectations, as a result of traditionally large pension adjustments in the sector, as well as associated cost recoveries from the government

KEY TAKEAWAYS

- 24-36 month deleveraging grace periods are possible for the right transaction
- Presenting a strong rationale for combining two businesses and a clear deleveraging roadmap is key
- Other factors, like sector-specific agency views (including for items such as pensions), can impact rating outcomes

SEPTEMBER 22, 2017**U.S. issuers owned by foreign parents need be mindful of rating agency implications in the context of M&A**

There are several potential ratings and related financing implications to consider in the context of foreign companies acquiring U.S. companies. (This is particularly relevant when the foreign acquirer looks to finance at the U.S. level)

- Scope of consolidation: Agencies may look outside of the U.S. creditor group and take a broader view of the credit
- Parent and subsidiary relationship/support: U.S. borrower may achieve ratings uplift, or conversely, be constrained from a ratings perspective
- Credit quality and availability of information of the parent are important considerations

KEY TAKEAWAY

- Rating agencies tend to look beyond just the U.S. borrower when evaluating the credit profile, which may influence financing terms and structure

DECEMBER 1, 2017

Pension contributions continue to be timely in light of potential tax reform

For most firms with underfunded pension plans, debt-financed contributions continue to make sense ahead of potential tax reform, given a lower potential corporate tax rate in 2018 or 2019. Pension contributions are tax-deductible, so firms making deductions ahead of tax reform can lock-in deductions at today's rate.

- In connection with the recently announced capital allocation plan, GE committed to a \$6bn debt-financed contribution
- Other large cap firms, such as UPS, Verizon, and Kroger have announced or completed debt-financed pension contributions in 2017

DECEMBER 1, 2017

Lessons learned from General Electric's recent dividend cut

The recent 50% dividend cut by GE has many management teams and Board members reviewing their dividend strategies. GE had several unique factors that drove the decision to reduce the dividend, but some lessons are broadly applicable:

- Companies should be cautious about shareholder distributions in excess of their free cash flow for prolonged periods
- It's important to be cognizant of where a company stands in relation to industry and broader peers
 - Even after cutting the dividend, GE trades at a dividend yield of ~2.6%, greater than the yield of the S&P 500
- Communication is key to any type of capital allocation shift
 - In the case of GE, the stock had sold off over 30% prior to the announcement, since management had communicated the possibility of a cut prior to the announcement
 - Selling pressure after the announcement was related to EPS and FCF guidance along with broader retail and yield investor selling pressure

KEY TAKEAWAYS

- Plan sponsors with a December 31, 2016 fiscal year-end have until September 15, 2017 to make deductible contributions to their pension plans for the 2016 tax year
- However, making a contribution before GAAP year-end allows it to be reflected in the annual 10-K pension disclosure
 - This disclosure is traditionally the starting point for rating agencies and equity markets to obtain the latest funding status, absent more recent adjustments
- Firms have also been exploring the contribution of other qualified assets to pension plans, such as stock or real estate

KEY TAKEAWAYS

- Depending on the facts and circumstances, cutting the dividend may be responsible from a corporate finance perspective
- However, absent a large negative catalyst, the market may still penalize firms that cut their dividends
- Dividends continue to remain important in today's low-yield environment, representing 44% of shareholder distributions for S&P 500 firms in 2016
 - While total annual distributions to shareholders from 2014 to 2016 has remained flat, the percentage of distributions in the form of dividends has increased 11%
 - Over 40% of the total return of the S&P 500 Index in the past 25 years can be attributed to dividends

OCTOBER 6, 2017

Indicators and trends, now that the “Unified Framework” is released

The million dollar question: will some form of corporate tax reform actually occur? Some trends we have noticed regarding the release of the September 27 “Unified Framework”:

- While there are indications that firms with higher effective tax rates or higher percentage of U.S.-based revenues have modestly outperformed those with lower effective tax rates (or lower percentage of U.S.-based revenues) since mid-September...
 - ... there is not clear evidence the market has factored in the potential benefit of tax reform into earnings, notably since the release of the framework
- Further to market movements, websites such as Predictit.org can serve as directional indicators for probabilities of select topics, such as “a lower corporate tax rate in 2017”
 - Their wager-based probability estimate increased from ~30% to 38% immediately following the release of the framework, however dropped back down to 30% one week later

KEY TAKEAWAYS

- Though there is no perfect barometer to measure the probability of tax reform, equity and betting markets can serve as helpful datapoints
 - Legislative process, and negotiations between Democrats and Republicans are the biggest hurdle

OCTOBER 6, 2017

View from the markets: Increased difficulty in regulatory review for foreign buyers seeking to acquire U.S. companies

The U.S. appears to be increasing its scrutiny of Chinese acquirers and markets are taking note. CFIUS, the Treasury Department-led Committee on Foreign Investment in the U.S., reviews transactions for potential national security concerns, and recent transactions imply an increased difficulty of review for both China and other countries.

- Major recent transactions requiring CFIUS approval, along with market-implied probabilities, include:
 - Genworth/China Oceanwide (20%); failed its third attempt at approval and is nearing merger-termination date
 - MoneyGram/Ant Financial (50%); is attempting its third approval attempt
 - Lattice Communications/Canyon Bridge; denied in September directly by the White House, with concerns about China’s role in the transaction
- Transactions involving non-Chinese buyers (such as Singapore) are also seeing more difficult CFIUS reviews

KEY TAKEAWAYS

- The market’s understanding of the new administration’s approach to CFIUS review is still evolving
 - CFIUS’ expanded areas of concern may include U.S. personal data and economic security
- Assumptions of “safe” transactions based on prior administrations should no longer be relied upon

OCTOBER 20, 2017

Low correlation, low volatility: Active managers in the spotlight

Very strong or very weak markets are usually synonymous with high correlation, as markets tend to become “one-way.” However, despite the persistent backdrop of equities reaching new highs, correlation among S&P 500 constituents is near all-time lows.

- Markets like these are conducive for “stock pickers,” giving active investors an opportunity to shine
 - VIX is near all-time lows and index moves have been de minimis
- In addition, trading flow of passive capital has been muted, so active flow is increasingly important
 - ETF trading volumes are down 8.5% from a year ago
- Stocks touting a differentiated story may be better positioned in these types of environments

OCTOBER 20, 2017

View from the markets: Collared stock transactions can lead to increased volatility for acquirers

On Thursday, October 12, AT&T’s stock price dropped by more than 6%, its worst one-day decline since 2012. AT&T option-implied volatility is at a five-year high, despite market volatility being near an all-time low.

- The AT&T stock price move was, and continues to be, exacerbated by merger arb investors trying to hedge their Time Warner stock
 - Precipitated by AT&T’s data release on October 11
- Recently, several large transactions have employed the use of collared stock as part of merger consideration, including: Rockwell Collins/United Technologies, Scripps/Discovery and Time Warner/AT&T
- Using collared stock will reduce shorting pressure on an acquirer’s stock but can increase volatility in certain situations

KEY TAKEAWAYS

- Could this be the opportunity for active investors to prove their worth, in the “active versus passive” battle?
- What happens to these patterns in the event of potential future macro volatility?

KEY TAKEAWAYS

Implications of collared stock transactions

- Day 1 – Less shorting pressure
 - Unlike transactions with fixed stock exchange ratios, merger arbs do not need to short the full amount of acquiring stock they expect to receive on Day 1. In fact, it’s possible their initial hedge may be close to 0. The reduction in shorting pressure from merger arbs may lead to a better Day-1 stock price reaction for the acquirer
- Near Deal Completion – increased volatility
 - Merger arbs who delta hedge their positions reduce/increase their stock hedges based on changes in the acquirer’s stock price. If the acquirer’s stock is in the bottom half of the collar, merger arb investors must sell more stock as the acquirer’s stock goes down, and must buy stock every time the acquirer’s stock goes up (selling low, buying high), causing exaggerated price swings. The gap lower in AT&T’s stock price last Thursday caused merger arbs who were delta hedging to sell tens of millions of AT&T shares to adjust the hedge to their aggregate position in TWX (one of the largest positions on the Street), exacerbating the move in AT&T’s share price

NOVEMBER 17, 2017

View from the markets: Recent antitrust approval hurdles in mergers between customers and suppliers

Companies acquiring a major customer or supplier may have more difficulty receiving antitrust approval for their mergers. On November 15th, Makan Delrahim, the newly appointed head of antitrust at the DOJ, aggressively dismissed the use of behavioral remedies. The elimination of behavioral remedies as a means to alleviate antitrust harm would indicate a dramatic shift in the antitrust review process for mergers

- AT&T's acquisition for Time Warner, once considered to be a virtual certainty, now appears in jeopardy
 - AT&T's battle with the DOJ will likely end in court with a judge who will decide the future of the merger
- It has been several decades since the last vertical merger was litigated in court; moreover, merger guidelines related to vertical mergers have not been updated for at least 30 years
 - The judge's opinion will provide companies with the first substantive guidance on what makes a vertical merger anticompetitive

KEY TAKEAWAYS

- Firms should work with advisors to carefully consider and anticipate potential regulatory and legal challenges in M&A situations
- Buyers and sellers should approach the negotiation of break-up fees with heightened regulatory hurdles in mind

DECEMBER 1, 2017

View from the markets: Equity markets might be playing catch-up on tax reform

On Wednesday, November 29th, equity investors moved (quickly!) from hedge fund darlings in the tech sector to corporate tax reform winners. Amazingly, the S&P 500 finished the day almost perfectly flat, but there was significant volatility in macro themes. Big winners included: companies with primarily U.S. revenue, regional banks, and high U.S. corporate tax payers. Big losers included: tech momentum, FANG, and hedge fund favorite Alibaba.

KEY TAKEAWAYS

- Investor rotation from tech to tax reform beneficiaries could continue if tax reform becomes a reality
- Corporates that pay high U.S. corporate tax are benefitting from new investor optimism about the tax reform process
- Corporates that have large overseas cash balances are not benefitting from this sector rotation (recently)
- Investors will be looking to companies for guidance on how corporate tax reform will impact EPS and shareholder distributions

SEPTEMBER 8, 2017

Yet another reason for accelerated contributions to underfunded pension plans

Despite limited details, rhetoric around tax reform progress has begun to pick up again...which should remind companies to reassess corporate finance actions that are more beneficial in a higher tax rate environment. For example, many firms this year have raised debt to contribute to their underfunded defined benefit pension plans. Kroger mentioned potential tax reform as a driving factor and raised ~\$1bn to increase its funding status from 80% to fully funded. Furthermore, *International Paper* highlighted potential tax reform as one of several drivers for its \$1.25bn accelerated voluntary contribution, outlining that:

- *“Cash tax benefit is now locked in prior to any potential reduction in corporate taxes”*
- *“Contribution is considered debt reduction by the [rating] agencies” (or neutral)*
- *“Pension Benefit Guaranty Corporation (PBCG) premiums... will be reduced by \$35-45mm per year”*
- *“Plan’s earnings on the early contribution are not taxed”*

SEPTEMBER 8, 2017

Derivative/Hedging accounting changes: Improve balance sheet risk management and limit P&L volatility

FASB’s Amendment on Derivatives and Hedging Activities (issued on August 28) will likely create more balance sheet flexibility for U.S. corporates, without associated P&L volatility. U.S. corporates can now early adopt and gain flexibility regarding partial-term interest rate hedges of fixed-rate debt, foreign currency carry trades, commodity hedging, and more. Mandatory adoption is required for fiscal years beginning after December 15, 2018 (January 1, 2019 for calendar year companies).

KEY TAKEAWAYS

- A tax-deductible pension contribution is more valuable in a higher corporate tax rate environment
- Ongoing cash flow pick-up benefit arises if PBGC premiums are reduced
- Rating agencies view the transaction as neutral to positive

KEY TAKEAWAYS

- **Interest rates:** Late and partial-term hedging of fixed rate debt to floating now permitted
- **Foreign exchange:** Improvements to net investment hedging, particularly to report the benefits of “carry” through the income statement
- **Commodities:** Component hedging will now be permitted if contractually specified
- **Simplification of hedge accounting process**

NOVEMBER 3, 2017

U.S. Corporate Tax Reform: Release of House bill text kicks off the process

On November 2nd, the House Ways and Means Committee released the Tax Cuts and Jobs Act bill. Some preliminary highlights are below, but it is worth noting that (i) provisions may evolve in the coming days and weeks, and (ii) the Senate is currently drafting its own version of the bill, after which both the House and Senate will need to reconcile into one bill. Stay tuned for more from the Corporate Finance Advisory team.

KEY TAKEAWAYS

- Corporate tax rate at 20%, with no phase-in
- Interest deductibility limited at 30% of U.S. EBITDA
 - No grandfathering of existing debt
 - A secondary limit may apply for firms with a large proportion of foreign EBITDA and mostly U.S. debt
- Immediate expensing of new and purchased assets for five years
 - Public utilities and real estate companies not eligible, but will retain full interest deductibility
- Territorial taxation system with:
 - 100% exemption of dividends from foreign subsidiaries in which the U.S. parent owns at least 10%
 - Deemed repatriation of offshore earnings: one-time tax of 12% on cash/5% on non-cash, payable over eight years
 - 10% tax on high-profit foreign earnings
 - Excise tax of 20% on U.S. purchases from foreign affiliates, unless election to tax those related profits in the U.S.

NOVEMBER 3, 2017

Cross-currency swaps more attractive under the new accounting rules

The FASB's amendment on Derivatives and Hedging Activities was issued this past August, with a significant favorable change to derivatives designated as net investment hedges.

- Traditionally, as highlighted in our recent publications December 2016 and July 2014, a U.S. company with foreign EBITDA (and “net investment exposure”) can issue foreign currency debt to^{2,3}
 - Reduce nominal interest expense, resulting in a benefit to earnings
 - Provide a hedge of FX risk, without volatility of FX to earnings (given the designation as a “net investment hedge”)
- If foreign currency debt issuance is not practical or desired, a derivative, such as a cross-currency swap, can synthetically replicate foreign debt, though the current accounting treatment is not as favorable
- However, under FASB's new Amendment, designating a cross-currency swap as a net investment hedge under the “spot method” will result in favorable accounting treatment similar to organically issued debt
- Early adoption of the FASB Amendment is permitted, and becomes required for fiscal years beginning after December 15, 2018
 - Many firms are preparing to early adopt

KEY TAKEAWAYS

- Foreign currency debt, whether organic or synthetic, can be an important part of the capital structure to both lower risk and save money
- Synthetic debt via cross-currency swaps will be a more attractive option going forward, in light of the new FASB accounting changes
 - Firms should explore early adoption and understand the benefits/considerations around this approach

NOVEMBER 3, 2017

Broadcom announces intention to redomicile in the United States

In remarks delivered at the White House on November 2nd, the CEO of Broadcom Ltd announced the company's intention to redomicile into the United States:

- Would change the parent company domicile from Singapore to the U.S.
- Will occur whether or not there is any corporate tax reform in the U.S.
 - The CEO stated “*The returns we can drive by continuing to pursue our strategic growth far outweigh the incremental taxes we would expect to pay by redomiciling in the USA*”
- However, final form and timing of a redomiciliation will be affected by any U.S. corporate tax reform
- Expected to be effected in a manner intended to be tax-free to Broadcom's equity holders, and will be subject to a shareholder vote

KEY TAKEAWAY

- Broadcom's recent announcement was tax-reform agnostic, but still highlights that some firms may reevaluate their domiciliation decisions in the context of tax reform

² For further reading, please see our December 2016 report *Lowering risk and saving money: Part II* at https://www.jpmorgan.com/pdfdoc/JPMorgan_CorporateFinanceAdvisory_LoweringRiskSavingMoneyII.pdf

³ For further reading, please see our July 2014 report *Lowering risk and saving money? A CFO's roadmap for foreign currency debt issuance* at https://www.jpmorgan.com/directdoc/JPMorgan_CorporateFinanceAdvisory_LoweringRiskandSavingMoney.pdf

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