M&A monitor

Q4 2020: outlook for the year ahead

Freshfields Bruckhaus Deringer

2021 outlook

What to expect in global M&A

As is traditional, our Q4 M&A monitor tracks deal data across the year and examines the trends that will shape activity in the 12 months to come.

In this edition we explain why the stage is set for an acquisition spree and take a look at some of the countervailing factors to watch in the year ahead – from renewed transatlantic antitrust alignment to the regulatory consequences of Brexit.

We also examine the impact of China's efforts to curb the power of its domestic tech giants and predict further changes to the increasingly complex global foreign investment review landscape.

Best wishes from us all at Freshfields for a prosperous and healthy new year.

2020 wrap-up

After the fall, the biggest spike in history

It should come as little surprise that deal-making in 2020 fell sharply year-on-year, with M&A down 18 per cent by value and 14 per cent by volume from the previous 12 months.

However, despite activity being the lowest since 2013, the second half of 2020 saw an unprecedented fightback. The 79 per cent uptick by value from H1 to H2 was the biggest half-year jump on record, driven by more than $1tn in deals announced in Q3 (only the sixth time in history that quarterly deal value has crossed this threshold).

Technology, media and telecoms was the biggest sector by value for the eighth consecutive year, with tech and digital assets the target in four of 2020's top 10 deals. S&P Global's $43.5bn buyout of IHS Markit was the largest acquisition since Occidental/Anadarko in Q1 2019.

The tailwinds set to drive deal-making in the year ahead

With vaccines starting to receive regulatory approvals, inexpensive financing still readily available, new investment classes like SPACs providing even more M&A fuel and equity valuations sky-high, conditions are primed for a deal-making surge in 2021. Indeed, the data suggests a rally may already have begun, with 2020's six biggest acquisitions all announced since the start of September.

Both the Dow Jones and the S&P 500 ended the year close to record highs, driven by soaring technology and healthcare stocks and the resolution of the US election. Corporates and financial sponsors were buoyed by the likely division of the US government, which will limit the ability of the progressive wing of the Democratic party to introduce major policy changes, including significant tax rises.

That said, the road to recovery in the months ahead will not be smooth. No one is underestimating the challenge of inoculating billions of people, while the new US administration will re-establish links with America's traditional allies in ways that could have a significant impact on deals.

The events of 2020 will polarise the corporate world, creating winners and losers among the businesses that remain. CEOs are under pressure to ensure they fall on the right side of the ledger, with deals seen as an effective route to success. Investors, too, regard M&A as an efficient way to boost share multiples, not least active managers who are under pressure to drive growth from their portfolios as money shifts to passive funds.

Change at the top set to quell acquisitions

While many CEOs are aiming for a fast start to 2021, for others the race is done. Speaking to deal-makers across the US, it's clear that having navigated their businesses through COVID-19, rancorous elections and the outpouring of emotion that has accompanied the ongoing fight for racial justice, a number of chief executives are set to step down in the year ahead.

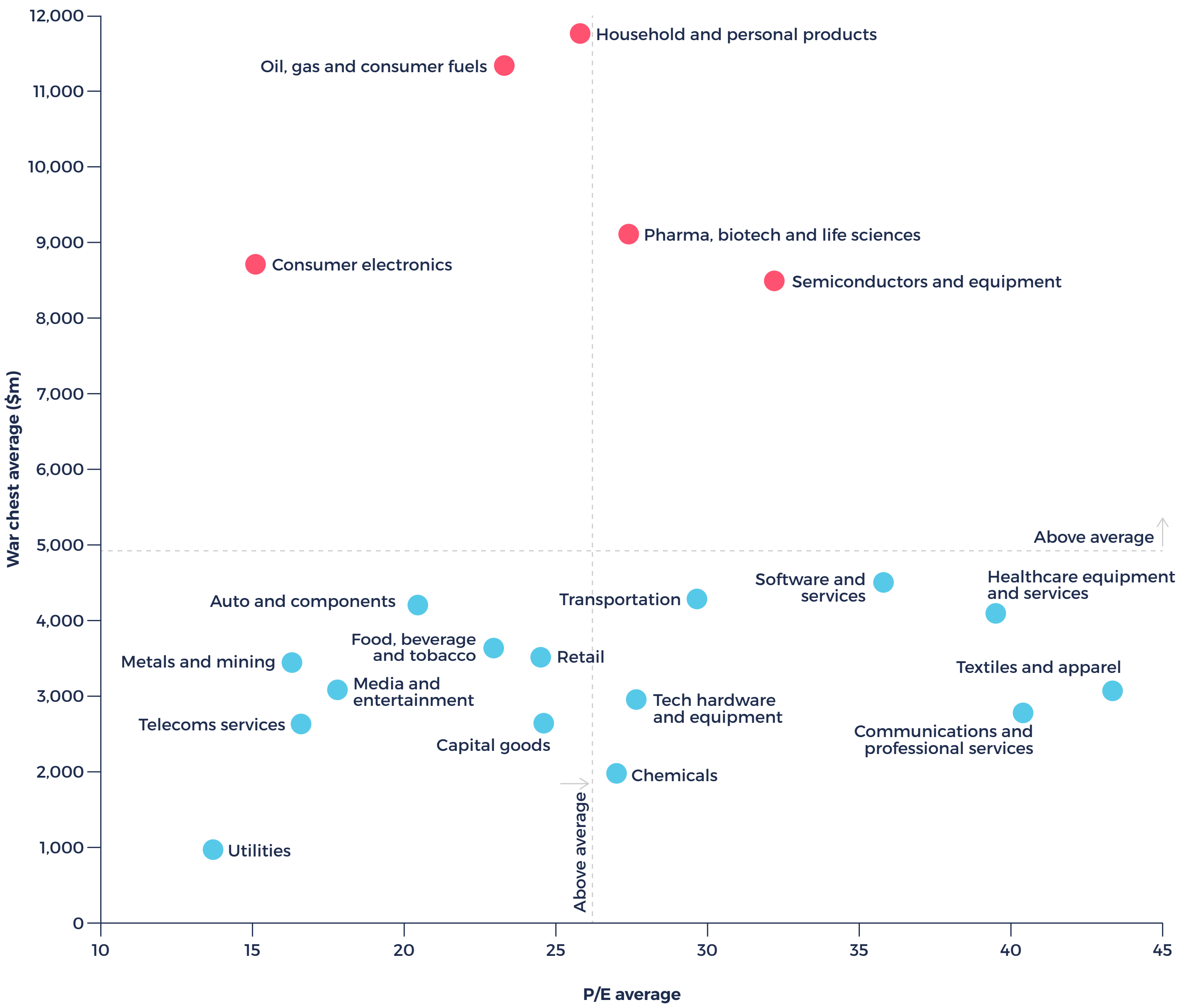
Handing the challenge of attacking the recovery era to the next generation could have an impact on M&A, with research by McKinsey revealing that more than half of new CEOs launch some form of transaction during their first two years in office. There is also an interesting study from the London School of Economics suggesting that the closer a CEO is to 65, the more likely they are to accept a takeover bid for their company.

A year of relative stasis has created huge pent-up demand for acquisitions (and some significant war chests among corporates in many industries), and we expect this to lead to more hostile bids by companies looking to emerge from the crisis as consolidators. This is likely to drive a run of pre-emptive divestitures (the so-called 'fix-it-first' technique), with antitrust enforcers keen to tackle concentrations of power and protect consumers battered by the economic crisis. The volatile macro outlook is creating further challenges, with earn-outs and contingent value rights increasingly being used to bridge gaps between buyers and sellers amid divergent forecasts for the target's performance. Likewise, parties whose transactions are taking longer to close thanks to the increasingly complex antitrust and foreign investment landscape are focusing on the interim operating covenants and regulatory risk allocation mechanisms in their deal agreements as they look to manage their exposure.

For more insights on recovery era M&A read our 2021 board memo here.

Primed for activity?

The sectors most likely to make acquisitions



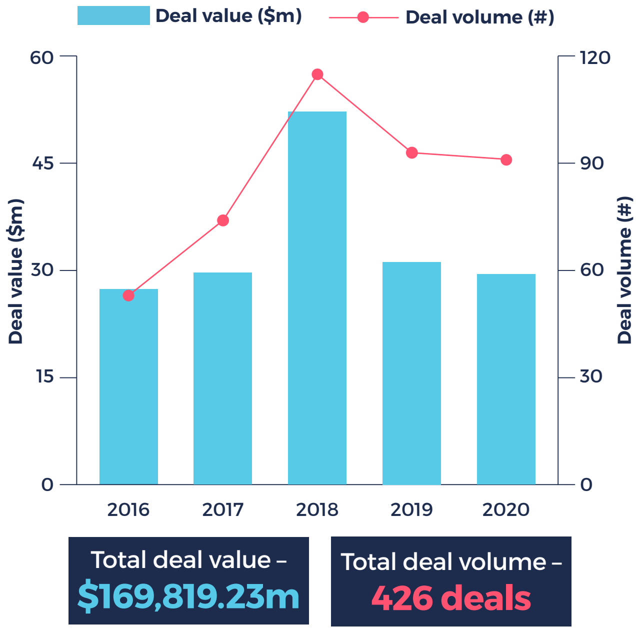
China brings its tech titans down to size

There was widespread shock when Ant Financial's IPO – on course to be the biggest in history – was abruptly halted in early November following the release of draft regulations that pulled the rug from beneath its lending model. A few days later, Beijing issued a second set of rules designed to limit the power of China's tech giants, this time targeting their transactional activity.

The guidelines announced by the State Administration for Market Regulation – China's antitrust authority – change the treatment of deals involving variable interest entities (VIEs), the corporate structures favoured by Baidu, Tencent and the rest. The VIE model enables China's internet platforms to raise cash overseas while circumventing the foreign investment restrictions that prevent non-Chinese ownership of strategic assets from rising above 50 per cent (China classifies tech platforms as value-added telecommunications businesses, which fall into this category).

At a high level, a VIE involves an offshore (often listed) entity using contracts, rather than shares, to 'own' operations on the Chinese mainland. Until the new rules were published, deals involving VIEs were generally not filed as the SAMR (and its predecessor, MOFCOM) tended not to accept them out of concern that approval would be considered an endorsement of the VIE structure's legality. There were signs earlier this year that the SAMR was heading in this direction with its approval of a Yum China transaction with a VIE element. But now the SAMR has declared all VIE deals should be filed as long as they meet the threshold – and with the big tech players in the government's sights, it may be a while before they test Beijing's willingness to approve their expansion plans.

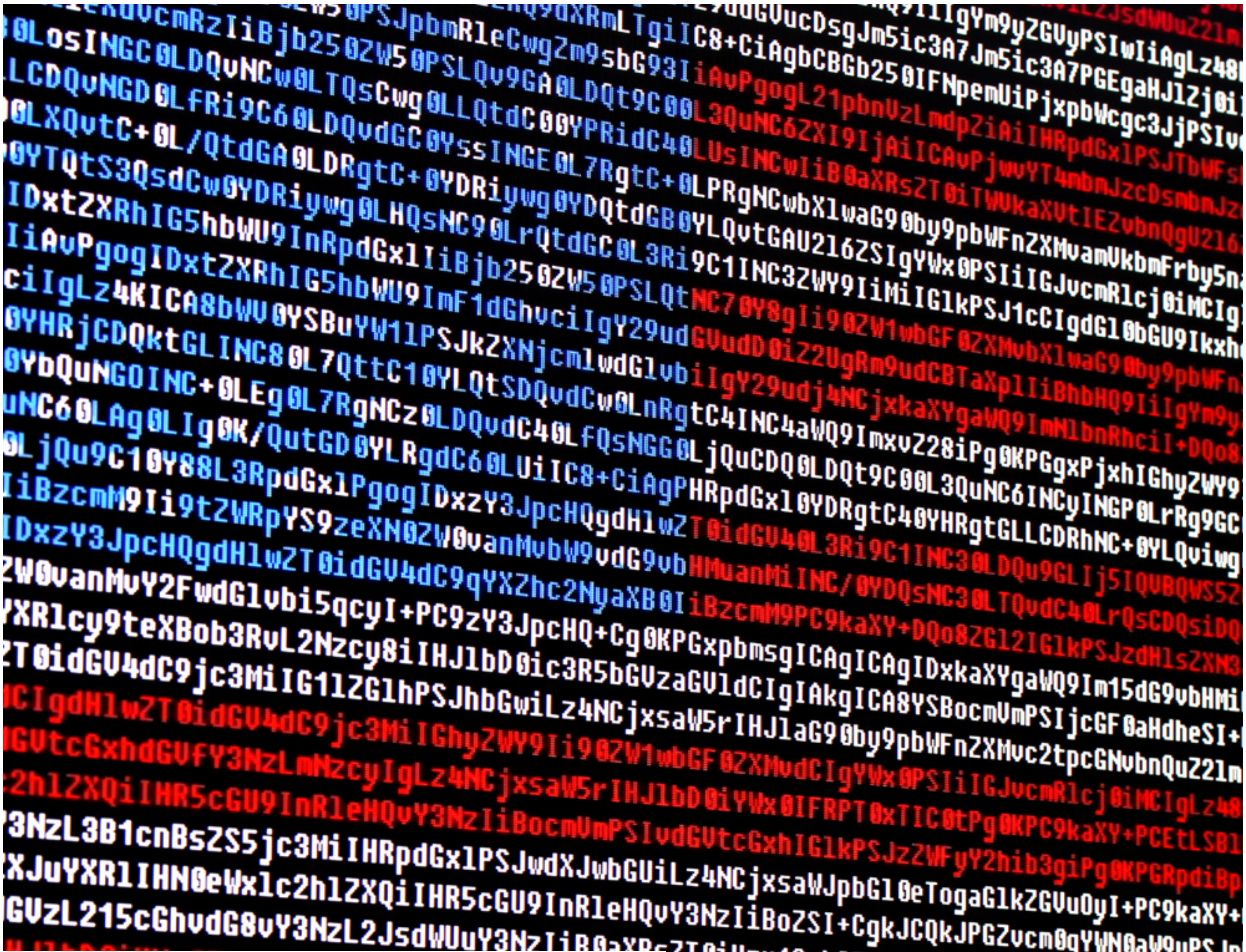
M&A among China's five biggest tech VIEs



Data combines deal activity by Alibaba, Tencent, Meituan, Pinduoduo and JD.com. Source: Refinitiv

Trade agreement to drive Asia-Pacific investment

The signing in November of the Regional Comprehensive Economic Partnership created a trade bloc that covers nearly 30 per cent of the world's population and a similar share of its GDP. While 83 per cent of the goods flowing between the 10 ASEAN nations plus China, Japan, South Korea, Australia and New Zealand were already covered by some form of deal, it is the first time China has entered into a multilateral trade partnership. The deal is set to drive closer integration of regional supply chains, so expect more cross-border investment and M&A between the signatories in the years to come.



Biden victory puts ‘killer acquisitions’ on notice

It’s not just in China where tech M&A is in the spotlight. Joe Biden’s election victory and a renewed focus on tech antitrust both at the European Commission and in the UK mean transatlantic antitrust enforcement of tech deals is expected to ramp up significantly in 2021. One area where this could be most keenly felt is in relation to ‘killer acquisitions’ – that is, buyouts of emerging technology start-ups by big tech companies.

Many tech deals have flown under the antitrust radar in the recent past either because they fall beneath the reportability threshold (as is the case in Europe) or because (in the US) the antitrust agencies were not minded to substantively review them, even if they were reported.

But in response to the phenomenal growth of big tech – which has only accelerated through 2020 – the EU has said it will now investigate any such bids referred by member states even where they don’t meet the filing requirements. Coupled with the zeal of the UK Competition and Markets Authority (CMA) to review international tech transactions (more on which below) and an expected increase in enforcement under the new US administration, the outlook for 2021 may be challenging.

Against this backdrop, many exit strategies will now need to account for this risk. And because the deals in question invariably involve a US buyer, we can expect moves by Washington and Brussels to align on theories of harm to boost the credibility of their enforcement efforts, and to play to each other’s procedural advantages to enable the strongest possible cases to be built on both sides of the Atlantic.

Buyers beware: why Brexit could spell trouble for cross-border deals

To antitrust (and co-operation) again, this time in relation to Brexit. With the UK no longer treated as part of the EU following the end of the transition period, the European Commission will no longer have jurisdiction to scrutinise mergers that affect the UK market. As a result, more transactions will face parallel reviews in both London and Brussels – meaning deal-makers could be in for a rocky ride.

In recent years the Competition and Markets Authority (CMA) has established a reputation as a regulator willing to tread its own path on deal approvals, with CMA decisions contributing to the collapse of a number of global (and often US-centric) deals. Of the nine mergers subject to a Phase II CMA review in 2020, just one was cleared unconditionally, with three blocked, four abandoned by the parties and the other only approved subject to a divestment remedy.

In preparation for Brexit, the CMA has been stepping up co-operation with its international counterparts, including by signing memoranda of understanding with both the US Department of Justice and Federal Trade Commission. The two sides engaged closely on the proposed merger between Sabre, the US travel software company, and its domestic rival Farelogix, a deal that foundered on CMA opposition. It was a similar story on Taboola/Outbrain, where the tie-up between the two US platforms was prohibited in the UK despite Washington giving it the green light.

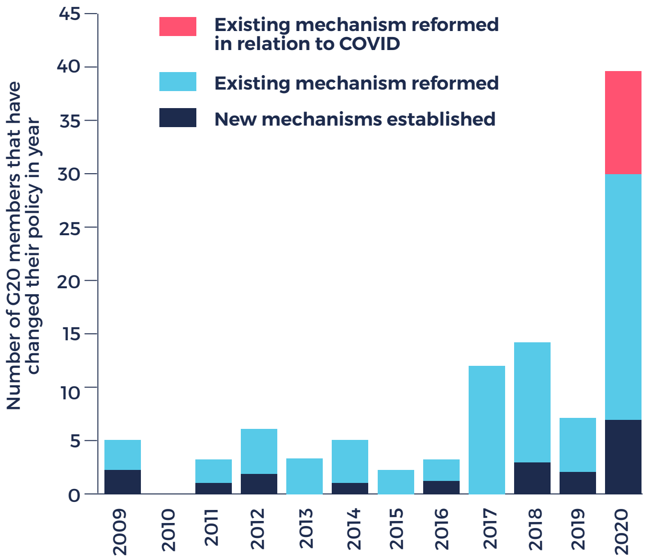
The reason the CMA process could spell trouble (or at least more headaches) for parties is because it's much easier for deals to be blocked in the UK than the US for example, given there is no need for the CMA (as both the investigator and decision-maker) to go to court to injunct a deal. Indeed, even where CMA decisions have been challenged by the merging parties, the Competition Appeals Tribunal, which is required to scrutinise CMA decisions under a judicial review standard, has typically sided with the regulator – giving it even more confidence to flex its muscles.

Foreign investment interventions hit historic high

The tightening of foreign investment restrictions around the world has been a recurring theme in recent monitors – and the economic fallout from COVID-19 has given governments further reason to scrutinise cross-border deals.

FDI interventions hit an all-time high in 2020, with G20 governments using their powers almost weekly. The situation is particularly fast-moving in Europe where the EU and member states have introduced a host of new measures over the past 12 months. The EU's FDI Screening Regulation covers investments in a range of critical infrastructure, critical technology, critical inputs, sensitive data and media, and contains no specific trigger threshold (leaving member states free to review almost any investment by a non-EU entity). This, coupled with the fact that many countries now have harsher sanctions at their disposal and can share information with each other and the Commission about FDI notifications and investigations in their jurisdiction, will make Europe a more complicated environment for foreign investors in the year ahead. The US, too, continues to have strategic technologies and sensitive data in its sights. More generally, while concerns about Chinese investment have been a big impetus for the expansion of FDI regimes, these frameworks are almost always neutral on their face and in practice are often applied to investors from strategic allies.

G20 policy reforms to protect national security, 2009–2020



Note: Information on 2020 only includes measures taken until mid-October 2020.

Source: OECD/UNCTAD monitoring reports on G20 investment measures 2009–2020.

At the same time, China itself is beginning to exercise various measures to protect home-grown technologies and address national security concerns from foreign investment.

Globally, pharma, biotech and other health-related activities – which were added to FDI watchlists during the pandemic – are likely to remain in focus even as we move into the recovery period. In 2021 we also expect further expansion of FDI restrictions, including in the UK where a mandatory and suspensory regime, which does not have any financial or share-of-supply trigger thresholds, is set to be introduced. While the measures are due to enter into force in the spring, any acquisitions launched after 12 November could be subject to retrospective 'call-in' review and remedies. Other jurisdictions to watch in 2021 include Australia, Austria, Belgium, Ireland, the Netherlands and Poland.

For deal-makers, the fast-moving nature of FDI restrictions can make potential issues hard to spot in diligence. Concerns can arise in seemingly minor parts of the target's business, such as small or even unprofitable government supply contracts. This unpredictability should be carefully weighed in risk allocation mechanics and long-stop dates because standstill obligations and sanctions for gun-jumping mean that transactions cannot move ahead while agencies are investigating.

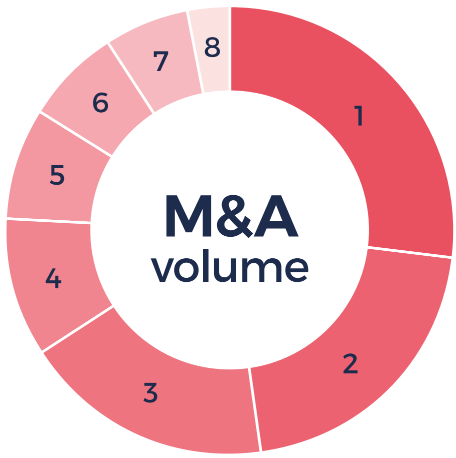
The good news is that many FDI concerns can be addressed via behavioural remedies (for example carve-outs of activities to prevent access to sensitive technology or data), but the bad news is that these measures can have a big impact on deal value and synergies in ways that can be hard to quantify at signing. From an execution perspective, buyers should be careful about accepting hell-or-high-water clauses or 'catch all' efforts obligations covering antitrust and FDI risk. However, the fact that there was a significant increase in FDI into sensitive sectors in the second half of 2020 shows that deals are still possible – with the right strategy.

To help our clients navigate the fast-changing foreign investment landscape, we're launching a quarterly FDI regulatory monitor in 2021. Register your interest here.

Global M&A YTD activity by sector

Sector		Value $bn	%
1	TMT	942.3	31.22
2	Financials	435.0	14.41
3	Industrials and materials	387.0	12.82
4	Consumer*	367.0	12.16
5	Energy and power	299.3	9.91
6	Healthcare	265.0	8.78
7	Real estate	251.0	8.32
8	Infrastructure and transport	71.8	2.38
Total		**3,018.3**	**100**

* Includes retail



Sector		Volume	%
1	TMT	11,872	27.35
2	Consumer*	9,087	20.93
3	Industrials and materials	7,933	18.27
4	Financials	4,460	10.27
5	Healthcare	3,531	8.13
6	Real estate	2,753	6.34
7	Energy and power	2,632	6.06
8	Infrastructure and transport	1,145	2.64
Total		**43,413**	**100**

* Includes retail

Source: Refinitiv | Data correct to 14 December 2020

Global M&A YTD – value and volume

	Global*	USA*†	Europe*†	Asia-Pacific*†
M&A value	$3,018.3bn	$1,215bn	$785bn	$830bn
M&A deal volume	43,413	10,893	11,970	15,856

Top 3 deals

	Global*	USA*†	Europe*†	Asia-Pacific*†
1	IHS Markit/ S&P Global – $43.5bn	Alexion Pharmaceuticals/ AstraZeneca – $38.8bn	IHS Markit/ S&P Global – $43.5bn	China Gezhouba Group Co/China Energy Engineering Corp – $14.4bn
2	Arm /Nvidia – $40bn	Xilinx /Advanced Micro Devices – $34.6bn	Arm/Nvidia – $40bn	Nipsea/ Nippon Paint Holdings – $9.9bn
3	Alexion Pharmaceuticals/ AstraZeneca – $38.8bn	Slack Technologies/ Salesforce.com – $27.5bn	Sberbank Rossii/Russian National Wealth Fund – $33.9bn	Tesco Stores (Thailand)/ An investor group** – $9.9bn

Inbound

Global* – **Inbound:** most targeted markets	USA*† – **Inbound:** markets investing into US companies	Europe*† – **Inbound:** markets investing into European companies	Asia-Pacific*† – **Inbound:** markets investing into Asia-Pacific companies
US 10,893 deals – $1,215bn	US 8,650 deals – $978bn	US 904 deals – $167bn	China 5,577 deals – $362bn
China 5,901 deals – $391bn	UK 237 deals – $57bn	UK 2,012 deals – $161bn	Japan 3,211 deals – $128bn
UK 2,580 deals – $278bn	Germany 73 deals – $42bn	France 1,042 deals – $86bn	South Korea 1,542 deals – $53bn

Outbound

Global* – **Outbound:** most acquisitive markets	USA*† – **Outbound:** markets US companies are investing into	Europe*† – **Outbound:** markets European companies are investing into	Asia-Pacific*† – **Outbound:** markets Asia-Pacific companies are investing into
US 10,481 deals – $1,232bn	US 8,650 – $978bn	US 601 deals – $141bn	China 5,719 deals – $378bn
China 5,700 deals – $370bn	UK 314 deals – $119bn	UK 1,858 deals – $129bn	Japan 3,082 deals – $111bn
UK 2,465 deals – $237bn	India 99 deals – $15bn	France 944 deals – $99bn	South Korea 1,502 deals – $52bn

Financial sponsor M&A – top 3 deals with buyside financial sponsor involvement

1. **$18.7bn** – Thyssenkrupp AG-Elevator Technology Business/ Thyssenkrupp AG-Elevator Technology Business SPV
2. **$17.3bn** – Livongo Health/ Teladoc Health
3. **$11.2bn** – Dunkin' Brands Group/ Inspire Brands

* Deal value includes net debt of target | † Includes domestic deals | Source: Refinitiv | Data correct to 14 December 2020

**An investor group comprising CP All PCL, Charoen Pokphand Holding Co Ltd, a unit of Charoen Pokphand Group Co Ltd, CP Retail Development Co Ltd and CP Merchandising Co Ltd