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The M&A landscape in 2021: A global picture

The global M&A market staged a remarkable recovery in the second half of last year, despite an escalating pandemic and deep political turmoil. As 2021 begins, we identify the most significant trends likely to shape dealmaking in the months ahead and ask: can growth be sustained?

2020 may well go down in history as one of the most remarkable years, including for the global M&A market.

Brought to an almost total standstill as Covid-19 took hold in the spring, dealmaking staged an extraordinary recovery from late summer onwards, as cash-laden investors returned to the market with force. Stock markets around the world underwent what came to be known as the 'everything rally', with prices across most sectors climbing rapidly.

As 2021 gets under way, the question is whether this return to growth is sustainable.

To answer this question we assembled a panel of five of Allen & Overy's M&A lawyers from around the world, comprising: Victor Ho, managing partner of the Beijing and Shanghai offices; Khalid Garousha, managing partner of the Middle East and Turkey practice; Eric Shube, head of U.S. M&A; and Astrid Krüger and Seth Jones, partners in our Munich and London offices, respectively.

In a session held on 14 January 2021, the panel identified five trends that could either propel or hamper dealmaking in the year ahead.

The Biden effect and its implications for U.S.-China relations

The election of Joe Biden as the 46th U.S. President is expected to herald a change of style in managing the relationship with China, but it is unlikely to result in a significant change in substance.

As Victor Ho put it: “While there is much talk about relationships ‘returning to normal’, while diplomatic engagement is expected to be more conventional, it is important to highlight that very key issues between the U.S. and China remain unresolved. In fact, four years on, the very important issues of technology, IP, trade and market access are even more acute. We expect the U.S. position will essentially be the same although the Biden diplomatic corps will engage differently.”

Eric Shube agreed. “In the spectrum of Trump policies, the one towards China was probably, at least quietly, supported on both sides of the political divide and the U.S. business community recognised that what Trump was trying to do was probably overdue. You’d expect Biden to proceed in a more diplomatic fashion, but I don’t think there will be a dramatic reversal.”

While the level of ‘decoupling’ as reported may be overblown, in the areas of technology and IP this is expected to remain an area of continuing conflict, with controls imposed by the Committee on Foreign Investment in the U.S. (CFIUS) and other increasingly stringent national foreign investment regimes globally continuing to pose challenges to outbound Chinese investment.

Instead, China will increasingly look to markets with lighter regimes, particularly in South East Asia. However, competition from well-funded investors around the world, willing to pay a high price for prized assets, will make deals considerably more difficult than in the past. As a result, Victor Ho predicted a growing focus on domestic transactions, as China continues to transition from an export to a consumer-led economy and accelerates out of Covid, with the private equity sector within China already ‘very active’.

For multinational investors into Asia, he also detected the emergence of a ‘two city strategy’, with Hong Kong growing in importance as a gateway to China and Singapore emerging strongly as a counterbalancing hub for investment elsewhere in the region. Worries about China’s new national security law do not seem to be deterring companies from investing in Hong Kong.

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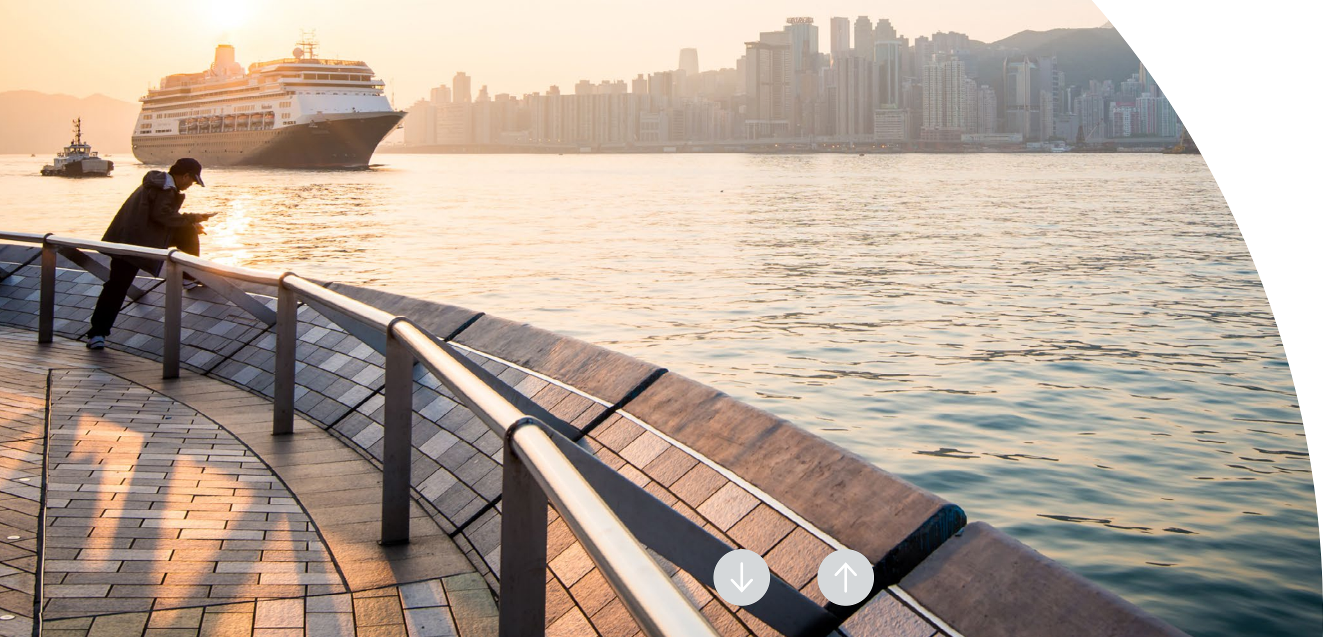


FDI controls – the tide moves (mostly) in one direction

The consistent trend, across many major economies, in recent years towards tighter national security controls on foreign direct investment (FDI) was only likely to grow, the panel agreed.

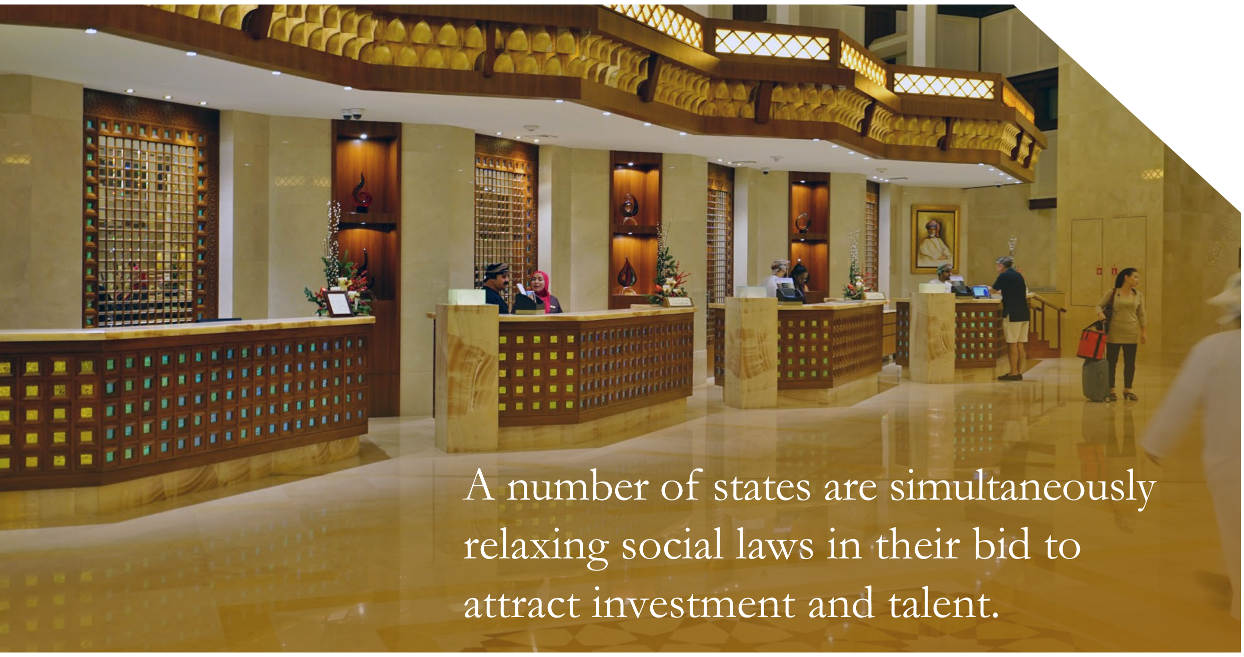
However, one region – the Middle East, and particularly the Gulf Co-operation Council states – was bucking that trend, observed Khalid Garousha.

These countries have historically imposed tough controls on foreign direct investment. However, with Saudi Arabia having taken the lead several years ago, regulations are being liberalised, including most recently in the United Arab Emirates where 100% foreign ownership is now being permitted across a range of sectors.

FDI liberalisation may not in and of itself dramatically change the appetite of foreign investors, he noted, so a number of states are now relaxing social laws in their bid to attract investment and, in particular, talent. For example, rules on the co-habitation of unmarried couples, certain LGBTQ rights and the consumption of alcohol have been eased in the UAE in the last month.

“These societal changes would have been unimaginable a year ago and are examples of how far and how quickly the GCC region is developing and adapting to reflect modern society,” he said.

In addition, the UAE is taking the lead in vaccine deployment. Second globally only to Israel in rolling out its Covid vaccination programme, the UAE is providing its residents with widespread and relatively easy access to the vaccine.



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The threat of the growing politicisation of FDI regimes remains an issue within the EU and the UK, which could make the transaction process more complex and perhaps more uncertain, Astrid Krüger and Seth Jones both suggested.

While traditionally FDI regimes focused mostly on defence-related technology, the definition of what constitutes critical infrastructure has been greatly widened in recent years, a process only exacerbated by the pandemic. In Italy, even food sovereignty now falls into this category.

“Almost all European countries have revisited their FDI rules and it’s not finished yet. So there is uncertainty,” said Astrid, pointing out that Germany, for instance, had been through two significant amendments to the rules, with a third round now underway. Mandatory filing is now required for all foreign acquisitions of critical infrastructure.

In addition, the EU is trying to take a more joined-up approach, requiring member states to notify it of any national security decisions, with the expectation that the systems in individual member states will become much more like CFIUS.

"All countries want to keep their sovereignty in making those decisions, but the EU getting involved could lead to tit-for-tat decisions. It will be far more political and not just based on economic rationality anymore," said Astrid.

The UK's new National Security and Investment Bill may include similar hazards. It requires mandatory filing across a broad range of sectors and gives the government call-in powers for transactions across all sectors that might raise national security issues.

"We may not get a clear definition of national security. If national security gets mixed with national interest, there's a risk of politicisation of the regime," said Seth. However, he added that the government's language to date had been proportionate, with ministers stressing that they do not want to impede foreign investment.

Eric Shube pointed to three significant developments in the CFIUS regime: a growing insistence on mandatory filing with a particular emphasis on critical technology, infrastructure and personal data; a greater willingness to pursue non-filers; and, as a result of the first two, a greater strain on CFIUS resources, which means investigations are taking longer. "As a practical matter when you are doing a deal you have to build in a lot of time for approval because even things that don't seem controversial take a long time," he said.

China is also re-enforcing its takeover controls by using a 'shield and sword' approach. This month (January 2021), it introduced a blocking statute similar to measures in the EU, having already created the beginnings of a Chinese sanctions regime and strengthened its tech export regime in the wake of the TikTok controversy, and maintaining strong antitrust controls.

SPAC to the future – a contrarian view

An outstanding feature of 2020 was the extraordinary proliferation of IPOs by Special Purpose Acquisition Corporations (SPACs) in the U.S., with many predicting that they will spread rapidly to Europe.

Eric Shube put the growth into context, pointing out that some USD83 billion had been raised through such IPOs during the year, compared with just USD16bn in 2019[1]. With 255 transactions completed, that adds up to more than one SPAC IPO per working day in 2020.

He added that it was unlikely that the massive growth in the use of SPACs would continue. "I think we have hit peak SPAC. I don't think they are going to take over the world," he said.

Much of their success to date has been down to how they are structured and to market conditions in the second half of last year, he argued. They could be more problematic in a more challenging environment.

A SPAC is essentially a blank cheque company that raises money through an IPO to make an acquisition, without a specific target in mind. Usually, under the terms of their foundation, they have up to 24 months to identify a target and do a deal.

The attraction for investors is that it amounts to an offer of free money. The proceeds are held in trust, and investors have the option to pull out if they do not like the eventual target, taking their money with them along with a warrant. It is relatively risk-free for investors. Sponsors too are well positioned, providing up to 3% of the capital invested but guaranteed to get some 20% of the equity. Unlike PE deals, sponsors can still make money even if the eventual acquisition trades down.

The real burden falls on those investors that stay on. That has not been a problem in recent months since, during the 'everything rally', there have been some notably successful SPAC transactions with targets trading up strongly.

However, Eric is cautious about SPACs. "It looks like a great investment, but the track record is quite mixed. In a more challenging market they are going to struggle to justify the inherent dilution in the structure," he said.

A further issue is the volume of SPACs that have yet to find a target. There were 255 new IPOs in 2020. By contrast, there have so far been only 90 de-SPAC deals – ie SPACs that went on to make an acquisition[2]. That means we enter 2021 with an overhang of SPACs trying to find a deal within the allotted 24 months, and with a relative dearth of assets being chased by a growing wall of money, this would be likely to force up asset prices and consequently reduce investment returns to SPAC investors.

There have been a handful of SPAC IPOs in Europe, particularly in the Netherlands. However, Seth pointed out that UK listing regulations currently make these deals challenging given the suspension of trading requirements when the M&A deal is first announced, although there may be a review of these rules as part of the promised post-Brexit review of listing requirements.

"I'm sure SPACS will look to Europe for targets – they are not going to go away," said Eric. "But I take the contrarian view of whether they will take over the world. It will be one tool in the toolkit, but they are unlikely to replace PE or strategic investors."

[1]Source: Dealogic
[2]Source: Refinitiv

New directions for new times – what will be hot in 2021?

The panel agreed that alternative investment funds would play an increasingly active role in pushing the market forward in the year ahead.

Seth Jones said private equity would continue to invest in Private to Public (P2P) deals, a trend that began in 2019 and that was one of the first to come back in 2020 as the market recovered.

Many of the traditional impediments to such deals are no longer such an issue with PE investors, including the potential to be in a public bidding war or their inability under takeover rules to lock down a deal at the time of an announcement. Increasingly, we are seeing competitive processes, big-ticket deals and funds clubbing together to do consortium transactions in the P2P space.

“Most of the big sponsors have done at least one P2P deal in the last two years,” he said. “There’s such a huge amount of capital to be deployed and all the signs so far this year is that the momentum is continuing.”

The same picture is emerging across Europe. “This is going to continue in 2021 and there are lots of rumours about potential targets,” said Astrid. “I think shareholder activism and transformative deals done in the U.S. are a good example of what could happen here. We usually catch up after a while.”

Khalid said that major GCC sovereign wealth and PE funds would become increasingly active. From March 2020 there was evidence that they regarded the pandemic as a significant buying opportunity.

“The strategy of the GCC SWFs (sovereign wealth funds) is to diversify away from dependence on petro-dollars and to deploy their capital across multiple sectors, asset classes and geographies and that will only continue in the year to come,” he said.

The Saudi and UAE SWFs are likely to continue targeting sectors such as technology, infrastructure, life sciences, foods, agriculture and renewable energy. At the same time, they are increasingly willing to move away from passive investing and towards taking majority stakes or even full ownership.

An expected increase in distressed deals brought on by the pandemic has not yet transpired as expected. Such deals may still happen, but the timing is uncertain, argued Astrid.

“We’re still undecided when the wave might hit us. Maybe it will be in the summer or autumn of this year when life goes back to normal, government stimulus programmes terminate, and the pause in insolvency filing obligations ends.”

A bright outlook, but some potential clouds

The clear consensus of the panel was that the strong growth in transactions at the end of 2020 has continued into the new year and is likely to persist in the months ahead.

Some markets will remain challenging. Chinese outbound investors will remain active but may find the going tougher. By contrast, inbound and domestic investment is likely to rise. GCC sovereign wealth funds will be highly active as they look to deploy "eye-watering" amounts of accumulated capital.

Similarly, in Europe and the UK, PE funds will play a prominent role not only as acquirers prepared to take on bigger and more complex deals, but also on the sell side as they look to take advantage of rising asset prices.

The year after a U.S. presidential election is usually a time of retrenchment, as the new government sorts out pre-election efforts to prime the economy. This time it is different, with significant confidence-building stimulus measures already pledged to repair the economic damage done by the pandemic.

One concern, however, is interest rates. These have started to edge up – most noticeably after the election result in Georgia handed the Democrats control of the Senate as well as the House. If rates continue to rise, it will affect asset valuations and could spark a slowdown.

In the UK, currency fluctuations, asset price inflation and more expensive finance could hold back the growth we are currently seeing, although as Seth Jones observed: "At the moment none of them are seen as particularly strong headwinds."

Eric Shube summed up the consensus feeling on the panel about the outlook for 2021. "Right now it seems all systems are go."

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