ALLEN & OVERY

The M&A landscape in 2022: A global view

Global M&A markets recorded another year of extraordinary growth in 2021 with transaction values soaring to a new record high of nearly USD6 trillion. As 2022 begins, we examine what underpinned that growth and ask if it can continue in the year ahead at a time of significant economic and political volatility.

The M&A market in 2021 defied even the most optimistic forecasts as the value of deals raced to a new record high of USD5.8 trillion, with growth across all sectors and almost all deal types.

The technology sector was particularly active, accounting for 20% of total deal value and worth over USD1 trillion, a performance that may well continue despite recent headwinds, including inflation.

The fundamentals in the technology sector remain robust. But the important point is that, for now, the M&A market more generally still looks to be strong.

The figures for 2021 are impressive, given the significant volatility the world continues to experience. So much so that it's quite hard to remember that in the first half of 2020, as the Covid-19 pandemic took hold, the market ground to a near standstill.

And although dealmaking came back very strongly in the second half of 2020, we were still left wondering, as 2021 dawned, whether this was a trend that could be sustained at a time of ongoing economic and political uncertainty.

To understand the main issues at play in the market last year, to track significant new legal and deal trends, and to look ahead to what 2022 holds for M&A activity, on 13 January we brought together a panel of partners from across Allen & Overy's global network to take stock and look ahead.

Chaired by London partner Jeremy Parr, the panel included Eric Shube, the New York-based head of our U.S. M&A practice, Khalid Garousha, managing partner of our Middle East and Turkey practice, and Dr Astrid Krüger, Claire Coppel and James Mythen, M&A partners in our Munich, London and Singapore offices, respectively.

Reflecting on consistent growth in transactions in recent years and an exceptional 2021, Claire put it well when she said "the levels of activity at the moment are extraordinary. When I became an M&A practitioner I was told the market was cyclical. But now it seems more like athletics, where year on year we're seeing the records get broken."

Before assessing the prospects for 2022 and whether this extended growth cycle can indeed be sustained, the panel began by identifying the key trends in the markets last year.

The big stories of 2021

Where next for SPACs?

For Eric, one key trend stood out in the U.S. – the explosive proliferation of Special Purpose Acquisition Companies (SPACs) – and he began by reminding the audience how these "blind pool" companies operate.

SPACs raise money through an initial public offering (IPO), then have two years to find a target in which to invest the funds raised. Investors are usually offered shares in the SPAC at USD10/share and a warrant. Proceeds are held in a trust until a target is found, a transaction known as the de-SPAC.

At this point shareholders have the right to vote on the proposed combination and to redeem their investment if they so choose and, typically, those that do withdraw are nonetheless allowed to keep the warrant. While institutional investors have, in increasing numbers, been following a redemption strategy, retail investors typically choose to stay invested in the business.

SPAC sponsors get 20% of the equity of the combined business for free – the so called "promote" that acts as an incentive for the sponsor.

Although blank-cheque companies like these are not new, their growth in the U.S. has been exponential in the last three years.

- 2019 – some 60 SPACs were created, raising around USD14 billion, which meant they accounted for 28% of all U.S. IPOs
- 2020 – 250 were launched, raising some USD80bn and accounting for half of all U.S. IPOs
- 2021 – 613 SPACs raised some USD160bn, equivalent to 63% of all IPOs in the U.S.

"These are staggering numbers", said Eric. "But after a really strong 2020 and a blow-out first quarter in 2021, activity cooled for most of the rest of the year."

He put that down to two issues in particular:

- "Sabre rattling" from the Securities and Exchange Commission, including changes to the accounting treatment of SPAC warrants and suggestions that there would be a crackdown on SPAC disclosures
- A mixed performance by SPACs in the aftermarket

Goldman Sachs illustrated this second issue with research published in September. It suggested that since February, a representative basket of SPACs had returned -35% compared with +14% for an S&P500 equity tracking fund.

"SPACs are great for sponsors, and IPO investors have typically done well because many redeem at the time of the de-SPAC and keep the warrant. But retail investors who stay with the SPAC have in many cases not done as well", he said.

It's an issue compounded by the fact that there are now some 575 SPACs out in the market looking for targets, with a 24-month clock ticking.

"That many SPACs chasing transactions is obviously going to impair deal quality", he argued. "And since a sponsor has a powerful incentive to find any deal so that it gets the "promote", there may be a misalignment with shareholders who would only be looking for a good deal. We've been waiting for that conflict to result in litigation in the U.S."

The first such case came before the Delaware Chancery Court in January this year concerning the SPAC takeover of MultiPlan, a healthcare data analytics company.

The de-SPAC closed in October 2020. One month later, news emerged that the company's principal customer, accounting for 35% of its revenues, was intending to stop using MultiPlan's services and planned to develop its own capabilities. MultiPlan's shares fell 40% on the news.

The court held that shareholders could bring a claim for breach of fiduciary duty against the sponsors. But the decision was focused on the failure to disclose the impending customer loss (which would have been relevant to the SPAC shareholders' decision as to whether or not to redeem) rather than a more general basis of entering into a deal that was not in the best interests of the SPAC shareholders.

However, argued Eric, the implications of the ruling were pretty clear. "It does seem to suggest that, in future, the court will take a hard look at the decisions that SPAC sponsors make, given the inherent conflict of interest."

SPACs are by no means exclusively a U.S. phenomenon, but the market is much less mature in both continental Europe and Asia.

Astrid pointed out that the number of SPAC issuances had grown in 2021, with Amsterdam, where 14 have been created, being the most effective market for SPAC creation.

There had been a number of de-SPAC transactions, she said, adding: "But we are not at the stage of asking if the interests of shareholders and sponsors are aligned. It's something we will have to watch as SPACs take over their targets in the next 15 to 20 months."

James pointed out that SPACs had been very active in searching for potential targets across Asia in 2021, but deals had become very hard to strike and activity appeared to be cooling down given that SPACs had not yet demonstrated that they were a more competitive liquidity option to IPOs in APAC. He doubted there would be a significant number of SPAC acquisitions in 2022 in the region, even though both the Singapore and Hong Kong stock exchanges had (belatedly and just as the market appeared to be slowing down) issued new rules on SPAC listings.

The public/private calculus

For Astrid and Claire, the boom in transactions, the availability of finance and the heightened competition for prized assets, had led sellers to weigh up new exit options.

As Astrid put it "we've seen huge M&A activity with a lot of money in the market and a lot of financial investors even looking at public targets which, in Germany, they previously have shied away from. There's been a lot of excitement. It was a year we would view as very positive."

Claire pointed out that 2021 was not just a record year for M&A, but also for IPOs, driven both by excess liquidity and the flight to the so-called Covid winners.

But the ebb and flow of the performance of public markets, usually dictated by the progress of the pandemic, had led PE Houses, strategic and management investors to change their tactics in real time.

She noted that in the spring and summer, as Covid-19 temporarily settled down, there was heightened enthusiasm for public markets. But in Q3, as Covid-19 uncertainty crept back in, there was a more muted sentiment towards IPOs and a pivot back to M&A as an exit route.

"What does that mean for 2022?" she asked. "While cash piles in the Middle East, for example, are leading some colleagues to be more optimistic about IPO activity in 2022, there's no doubt drivers of potential volatility are there – Covid-19, inflation, product supply chain issues and geopolitical tensions. Maybe these will continue to drive sellers to the private market and the M&A music won't stop."

Technology dominates "busiest" year for Asia

2021 was one of the busiest years ever for M&A in Asia, as cross-border deals outside China picked up dramatically after a lull, and domestic dealmaking within China underwent a resurgence.

As James put it, "across the region, activity has been driven by the basics of economic recovery, strategic consolidations accelerated by the pandemic and cash-rich PE investors and SPACs running around Asia looking for deals."

Technology was by far the busiest sector, accounting for some 30% of regional deal value during the year. The two standout deals in the sector were the:

- near USD40bn combination of food delivery and ride-hailing giant Grab with the Altimeter Growth Capital SPAC
- USD18bn merger of Indonesia's GoJek and Tokopedia to form the GoTo Group

The telecoms sector also saw a spate of consolidation deals as operators sped up their efforts to digitise and adopt and rollout 5G. Significant mergers were announced in Thailand, Malaysia and Indonesia. James noted that the timing of each of these deals had been fortuitous as the business imperative for them had come at the same time as a softer regulatory environment and a lighter touch to FDI in countries looking to solicit inbound investment.

But there was also a continuation of broader trends seen in the region over the last few years. "Covid-19 has tended to accelerate lots of the trends we've been seeing over the last 10 to 15 years – namely, digitisation and increasing capital investment into sectors targeting the region's growing middle class." As a result, financial services, healthcare, education and consumer products continued to be popular sectors for inbound investment.

Increased international PE activity in the Middle East

Khalid noted that 2021 has seen a range of positive developments in the Middle East, including increased auction activity, more take-private transactions, a significant surge in IPOs, particularly in the UAE and Saudi Arabia, and continued heavy investment by the region's cash-rich sovereign wealth funds.

Increased interest in the region by international PE Houses was also a notable trend, with some looking to establish offices in key centres to "plant a permanent flag in the region".

"Up until about three years ago, international PE activity in the Middle East was fairly rare", he noted. "But we're now seeing more and more of it and the size of the PE cheques is growing."

For example:

- 2019 saw CVC invest USD1bn in a Dubai-based education business and BlackRock and KKR invest USD4bn into a UAE oil pipeline business
- 2020 saw a consortium including Brookfield and Global Infrastructure Partners invest USD10bn in a UAE gas pipeline company
- 2021 brought news that BlackRock had joined forces with a Saudi investment company to invest USD15bn in Saudi Aramco's gas pipelines

"Year on year, we are seeing an increased confidence by international PE to invest in the region. You now see them on pretty much all the significant regional auctions", he said. A new feature enabling these deals is the increased availability of acquisition finance, which was previously not the case, and greater confidence in the regulatory environment. Exit options are also increasing, whether through IPO, trade or secondary sales.

"I expect this trend to continue", he said.

Legal developments and deal dynamics

Time pressures build

The sheer volume of M&A activity and the heightened competition for prized assets had a significant impact on deal timetables in 2021, an impact that both Claire and Astrid saw in the UK and in continental European markets.

The period between deal announcement and signing accelerated significantly, they suggested.

In the UK this was often due to pre-emptive moves to head off competition for sought-after assets both by PE Houses and trade buyers looking to achieve inorganic growth through acquisitions to ease margin pressures.

PE houses, for whom dealmaking is "bread and butter", found themselves at an advantage, set up to move quickly to close transactions. The data shows that they were the clear winners in the market.

The trade buyers that were most successful were those that had processes in place to make decisions at high speed. Others fared less well.

As Claire put it "a number of corporates lost out, not because they were unwilling to pay high prices, but because internal sign-off procedures hampered them or because they were not willing to invest enough upfront in due diligence to demonstrate to sellers that they really meant business."

By contrast, she noted, timetables for gaining regulatory approvals got longer and longer during the year, reflecting the growing complexity of navigating a myriad of antitrust and FDI control regimes. That meant the time between signing and closing was often extended.

Many authorities became inundated during the year, often delaying firing the starting gun on approval processes just to manage an overwhelming workload. This dynamic can have a serious knock on effect for dealmakers, impacting the longstop date, commitments to engage proactively with regulators and, inevitably, on deal financing.

The rise and rise of W&I insurance

The use of Warranty and Indemnity Insurance came later to the U.S. market than other jurisdictions.

But W&I Insurance – or Representation and Warranty Insurance, as it is known in the U.S. – is now the market standard, Eric told the audience. Although there was a drop off in its use in the early days of Covid-19, it picked up again from late 2020 onwards in the U.S., as in other markets.

Originally introduced in the U.S. by PE sellers eager to ensure they could achieve a smooth exit and distribute proceeds to their limited partners, it quickly became adopted by strategic sellers too. And the prevalence of insurance has led to changes in market practice at the SPA negotiation stage.

Increasingly, buyers have seen that the use of the insurance product is beneficial to them and their expectations about the SPA terms have increased as a result. U.S. buyers now demand broad and detailed representations about the target business (even broader than before) and dismiss seller objections on the basis that the insurer, not the seller, is bearing the risk. While this argument is largely true, and generally carries the day, Eric noted that there are a few resulting issues that sellers do need to be mindful of.

Sellers need to consider these issues in particular in signing up to a wider range of representations than in the past. He warned:

- In the U.S., sellers don't just disclose the data room against the representations, but rather need to prepare a specific disclosure schedule. The broader the reps, the more work there is to do (and typically at the last minute). There is increased completion risk because the broader representations made at signing get repeated at closing and so their accuracy will be tested again. However, one mitigating factor is that the "bring down" at closing in the U.S. is typically to an MAE standard.
- More interestingly, Representation and Warranty Insurance policies usually contain a fraud carve out. If the representations that were made turn out to be false and there is some evidence that the truth was known within the seller's organisation, insurers can bring a fraud claim against the seller. The fraud may not be deliberate, but there is a risk that the deal team, lacking access to the rank and file business employees to confirm the relevant facts, because they are not "over the wall", may miss something.

As Eric put it "discussion of representation and warranty packages in the U.S. has moved from its original focus on what the core premises that the buyer is relying on are, to what reps the seller can make without taking on an unreasonable risk of fraud liability."

FDI controls – the regions diverge

While in many jurisdictions we are seeing a significant tightening of controls on Foreign Direct Investment on either national security or national interest grounds, this is far from a general trend, as both Khalid and James pointed out.

In both the Middle East and in many Asian countries the trend has been to move away from very tight restrictions on foreign ownership towards greater liberalisation.

Although he conceded that this was bucking a trend in many other global markets where more protectionist policies are on the rise, Khalid pointed out that "for several years we've seen restrictions relaxed across all of the Gulf Co-operation Council states. Today, it is possible to have 100% foreign ownership in a number of sectors, which is pretty transformative."

That would not, in itself, dramatically affect investor appetite in the GCC. Other factors were important, including:

- ease of doing business
- ability to repatriate capital
- increased sophistication of local laws
- low, or no, taxes

Indeed, all this was part of wider moves to liberalise and modernise the GCC to attract more foreign investment. Social change was coming alongside economic reform, he noted – such as the liberalisation of laws on the cohabitation of unmarried couples in the UAE and its more recent decision to change the weekend from Friday and Saturday to Saturday and Sunday to match up with global markets.

"All these things are a reflection of the way the region is going", he said.

Political expedience plays a role

James saw a great similarity with the how things are developing across Asia, with far greater liberalisation than in the past.

But he noted that FDI policies tended to fluctuate with election cycles or, in countries without elections, transfers or transitions of leadership.

"Pre-election, governments tend to become more protectionist, toughen up laws and offer incentives to domestic players, but these are swiftly reversed post-election as the new executive needs to access foreign capital to deliver on its election promises or its plans", he said. In the last two years there had been polls in Indonesia, Singapore, and Myanmar, as well as changes in government in Vietnam and Malaysia that had demonstrated this trend.

"With the exception of Myanmar, which has gone backwards, we've seen greater liberalisation and encouragement of foreign investment in each of these markets which has been a real boon for M&A."

Indonesia's so-called Omnibus Law – which last year repealed 70 pieces of existing legislation and introduced a positive, rather than negative, list of possible investment areas – was the most obvious example of this change of attitude.

By contrast, in the Philippines, which is heading for elections later this year, some aspects of policy around investment were toughened up, mostly targeting Chinese investment. Equally, the greater amount of domestic M&A in China, in policy terms, may link back to the run up to the National Congress in November where President Xi is expected to see his current term of leadership extended.

One other development is the growing preference of some governments (including, recently, Vietnam, Thailand and Bangladesh) to rely on competition laws as a kind of proxy for FDI laws, because they are seen as more palatable from an optics and trade agreement perspective. It is an approach that China took in the 1990s and early 2000s, where, as James put it "it creates some sort of legislative legitimacy for laws solely designed to protect national interest."

Europe learns to live with much tighter controls

"The trend in Europe is going in exactly the opposite direction", said Astrid.

A few years ago, Investors were used to grapple with merger controls only, except in the context of military-related assets. Now, almost all countries have, or are introducing, restrictions on what is regarded as critical infrastructure. That includes pharmaceuticals, technology assets and anything to do with energy.

Voluntary reporting regimes, which often applied post-closing, have also been replaced by prohibitions that apply pre-closing. "So now you have to make an FDI filing to be permitted to close the transaction. That really is a change."

Not all countries were as far advanced as others in applying these new controls, meaning that investors had to navigate a range of different regimes in doing deals that cross borders. "That can be a time-consuming process", she said.

But on the positive side, many of the new regimes had now stabilised.

"Twelve months ago, we were struggling to pin down what the process would be", she said. "Now, at least in the larger countries, we know pretty well how long authorities will take, we can depend on them providing answers within a prescribed period and, only if the asset is difficult, will those periods be prolonged."

For the U.S. – China is the focus

The priority of the Committee on Foreign Investment in the U.S. (CFIUS) is clear, argued Eric.

"Rather than the U.S. liberalising or going backwards, the U.S. FDI story is almost exclusively a bi-lateral U.S./China one. CFIUS is laser-focused on Chinese investment in the U.S., in particular in the area of data privacy… and its resistance to Chinese investment in the U.S. is at an all-time high."

Many thought that the Biden administration might take a more lenient approach on this issue than seen during the Trump presidency. In fact, argued Eric, the stance is equally strong, if not more so.

CFIUS does not restrict itself to cases that have been voluntarily or mandatorily filed. Often, it will investigate deals done years after the event. It may insist on remedies such as demanding that local board directors are CFIUS-approved and U.S. citizens. And its reach is increasingly extra-territorial.

In response, China has beefed up its own FDI controls with both U.S. and European investors in the frame. And there has been action on both sides in the securities market. The SEC has cracked down on disclosures by Chinese issuers, moving to limit VIE structures where an offshore issuer is ultimately controlled by a Chinese entity. China, in turn, has been discouraging its companies from seeking U.S. listings.

In the UK, which has significantly toughened its own FDI controls moving further than many other countries in Europe and elsewhere, the long arm of CFIUS, way after a deal is completed, is evident, argued Claire.

"The view among experts is that CFIUS is not looking at a static picture of the target and the foreign investor. Rather, it is thinking through how the parties might combine down the track to present a security threat."

What to expect in 2022

The panel's generally optimistic view on the prospects for M&A in the year ahead was well summed up by Khalid. He predicted that significant volumes of capital will continue to be deployed on regional and global markets by Middle Eastern sovereign wealth funds and the investment arms of regional governments.

Outbound investment

The investment would, he argued, continue to reflect two key strategic priorities, namely to promote the physical and social infrastructure of the region and to invest in assets outside the region, allowing it to diversify away from a dependence on hydrocarbons.

Sovereign wealth funds of the UAE and Saudi Arabia, in particular, are sitting on significant pools of capital that they are eager to deploy. Their investment strategies are evolving, moving away from passive investments to take majority or 100% stakes.

In addition, they are gaining confidence from recent successful exits, as exemplified by Mubadala's USD2.6bn listing of chipmaker, Global Foundries, on the New York stock exchange in 2021.

"Their investment strategies, alongside the sophistication of their investment teams, the sheer size of capital to be deployed and their ambition, will start to move markets and they will inevitably start to influence global M&A investment trends", he said.

The search for yield and growth

James noted that the investment pipeline in Asia for 2022 was "very strong" as private capital continued its search for yield and trade players looked for growth.

"A lot of dealmaking last year was driven by private fundraising and revamped corporate strategies in the light of Covid-19, and we don't see this changing", he said.

"We will see a number of market consolidations in traditional sectors and growth in new areas such as infrastructure and renewables. Pervasively, across all of this, it is the digital transformation in a number of different industries which is going to stimulate deal activity."

Activists return

Claire predicted a resurgence of shareholder activism in 2022.

"It was relatively subdued in 2020 and in the first half of 2021, but it is now coming back with a vengeance", she said, putting that down to three main issues:

- the market has become less sympathetic about companies considered to be using Covid-19 as a cover for bad performance
- activist funds needing to take action before reaching time limits for the funds they have raised
- the growing focus on all three components of the Environmental, Social and Governance (ESG) agenda, but particularly on the issue of energy transition

"Activism is very high on boardroom agendas now and rightly so. The market has shown that no company is too big and no chairman too experienced to fall victim to an activist attack", she said. "It is never a comfortable ride."

Inflation – the sleeping bear awakes

Rising inflation remains one of the most obvious threats to continued growth, as Eric underlined.

January saw the release of the latest U.S. numbers showing inflation climbing 7% in the year to December, its fastest rate in nearly four decades.

Although Jay Powell, Chairman of the U.S. Federal Reserve, had described it as "transitory", and although some saw it as a short-term after-effect of the pandemic, there was some doubt, Eric argued.

"The inflation genie is out of the bottle and it's affecting all aspects of the economy, including the M&A market."

Inflation is generally a negative for transactions because it reduces the present value of future cash flows and depresses valuations, making companies reluctant to sell assets. Inflation will also increase borrowing costs, after a prolonged period of very cheap money. The market is expecting the Fed to increase interest rates at least four times this year.

"At some point, these hikes will slow the economy which is not helpful for M&A", he said, particularly if buyer and seller price expectations become increasingly out of line.

"The trick is the so-called soft landing. If the Fed can cool inflation expectation without sending the economy into recession, then we'll have the Goldilocks outcome that will be great for everyone, including the M&A market. If there is an overcorrection, that will be a head wind for 2022."

Astrid admitted that all eyes were on the inflation situation and U.S. moves to use monetary policy to bring it under control. But she remained optimistic:

"There's still a lot of money in the system to be invested and the European Central Bank is, maybe, less aggressive on interest hikes compared to the U.S., so we are still expecting a lot of M&A activity."

Contacts

Click on a photo to read their full profile on allenovery.com

Claire Coppel
Partner – London
Tel +44 20 3088 2703
claire.coppel@allenovery.com

Khalid Garousha
Managing Partner – Middle East and Turkey – Abu Dhabi
Tel +971 2 418 0470
khalid.garousha@allenovery.com

Dr Astrid Krüger
Partner – Munich
Tel +49 89 71043 3102
astrid.krueger@allenovery.com

James Mythen
Partner – OUE Bayfront
Tel +65 6671 6077
james.mythen@allenovery.com

Jeremy Parr
Partner – London
Tel +44 20 3088 3383
jeremy.parr@allenovery.com

Eric Shube
Head of U.S. M&A – New York
Tel +1 212 610 6366
eric.shube@allenovery.com

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. Allen & Overy LLP is a limited liability partnership registered in England and Wales with registered number OC306763. Allen & Overy (Holdings) Limited is a limited company registered in England and Wales with registered number 07462870. Allen & Overy LLP and Allen & Overy (Holdings) Limited are authorised and regulated by the Solicitors Regulation Authority of England and Wales. The term partner is used to refer to a member of Allen & Overy LLP or a director of Allen & Overy (Holdings) Limited or, in either case, an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings. A list of the members of Allen & Overy LLP and of the non-members who are designated as partners, and a list of the directors of Allen & Overy (Holdings) Limited, is open to inspection at our registered office at One Bishops Square, London E1 6AD.

© Allen & Overy LLP 2022. This document is for general information purposes only and is not intended to provide legal or other professional advice.