M&A Insights

H1 2022

Private capital weathers the storm – but for how long?

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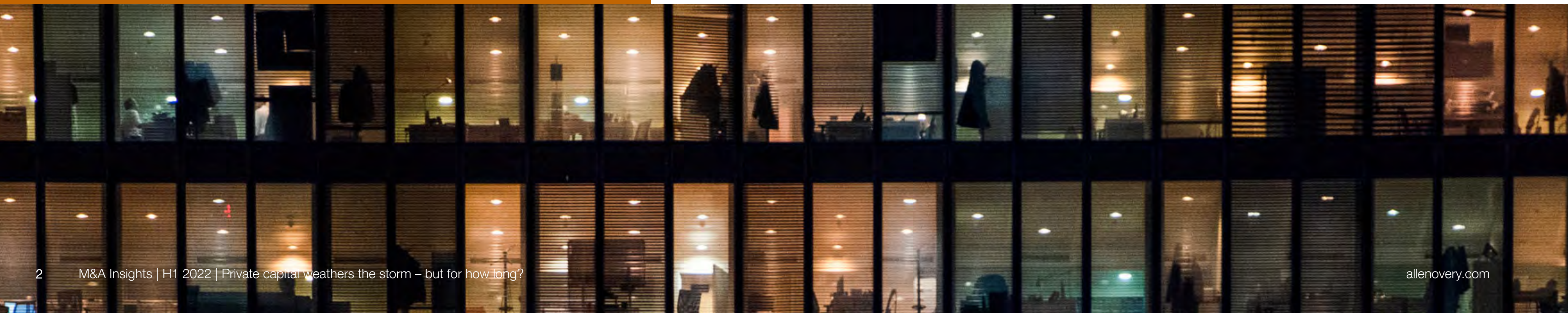
Global M&A transactions drop over 20%, but bright spots remain

The value of global M&A transactions dropped 21% when compared to the record high of H1 2021, although deal values still broke USD2 trillion.

Global deal volume also decreased by 17%, but a drop from last year's record levels could perhaps be expected, with macro events such as inflation, interest rates and the Ukraine war creating a more challenging deal market. Even so, this first half was higher in value than any year pre-2018, and was the third highest H1 on record. Interestingly, global M&A value was greater in Q2 than Q1, although volume slowed, and this made Q2 2022 the third highest Q2 on record.

The resilience in the market was boosted by a rise in megadeals worth more than USD10 billion, up over 10% in terms of deal value. However it remains to be seen if some of these megadeals might fall through, or take longer to close, due to a trend towards greater regulation in many countries.



Regionally, U.S. deal value was down 28% and volume down 22%, mirroring the global numbers. Most regions suffered a decrease, with MENA the highest with deal value down 49% and deal volume down 22%. Europe only suffered a slight decrease, with deal value down 4% and deal volume down 8%. India was the only major economy to see an increase, benefitting from a jump in deal value of 124% while deal volume climbed 32%.

Real estate was the only sector to see growth in global deal values, recording a 16% lift which resulted in a record H1 despite deal volume dropping 3%. The healthcare sector saw the largest decrease in deal value globally, down 45% and the volume of deals down 31%. TMT dropped 25% for value and 18% for volume, but that still represented the second best H1 on record by both metrics.

Private equity groups continued to do deals, with the global transaction value of private equity-backed M&A up 2% to mark a new record H1 (last year's H1 was the previous record). While overall deal volume was down, private equity claimed its largest-ever share of overall deal making, accounting for 26% of total M&A so far this year.

Two other private capital asset classes, infrastructure and growth capital, both explored in this edition, also fared well. Infrastructure (including Transport) benefitted from a record H1 by value, and growth capital a record H1 by number of deals.

> "Megadeals worth more than USD10bn, were up over 10% for deal value."

Real Estate M&A booms in H1 – but which assets will stay the course in uncertain market conditions?

Global M&A may have lost its fizz in the first half of the year, but real estate deals were back with a bang after a slowdown during the pandemic.

Our data shows that the value of global real estate M&A deals hit USD236 billion across 1,642 transactions in the first half of the year – the best start to the year in over a decade – and real estate transactions accounted for over 10% of all global deals by value in the first half of the year. However rising inflation, interest rates and supply chain issues are likely to take the heat off the market in the second half of the year.

The strong start to 2022 was fuelled by a return of confidence to the sector, as well as investors capitalising on changes to the way we work, live and play that were accelerated by the pandemic.

The bounce back in the real estate sector was in sharp contrast to the overall M&A market, which saw a 21% decline in deal value compared to the record-breaking first half of 2021.

Increase in value of global real estate M&A transactions
H1 2022 vs H1 2021

Real estate transactions as proportion of global M&A transactions

Note: Figures represent deals announced between 1 January and 30 June 2022.

Data provided by

Optimism returns in global property investments

The pandemic caused real estate mergers and acquisitions to all but grind to a halt in 2020, as investors assessed the damage that stay at home orders wreaked on the global property market. Pent up demand and growing confidence in the sector helped fuel a market rebound in 2021. But the first half of 2022 saw a renewed optimism in global property, with a flurry of interest in assets benefitting from long-predicted changes to consumer behaviour that were supercharged by the pandemic, such as a shift to online retail, growth of cloud services and popularity of staycations.

Changes to work, life and play

This was particularly evident in the stand out transaction of the first half: Blackstone's EUR21bn recapitalisation of European last mile logistics business, Mileway. Warehouses and logistics centres have become hot assets over the past two years, as the pandemic forced shoppers to stay home and boosted online spending. This has increased demand for logistics centres that deal with the final leg of a product's journey from the warehouse to the customer's door.

We view the Mileway deal, which is one of the largest private real estate transactions, as a vote of confidence in the sector as Blackstone maintained its investment in the asset, rather than selling the Amsterdam-based platform. In the U.S., we have seen increasing demand for logistics assets, with Singaporean investor Mapletree Investments snapping up two portfolios of logistics assets worth USD3bn across the country in 2021. While in China there has been a wave of consolidation of third party logistics players, as companies look to gain scale and drive down costs in this rapidly expanding sector.

Data centres

There has been continued interest in data centre investments, which is also the case for infrastructure investors. The pandemic caused a boom in home working, forcing many businesses to move their operations to the cloud for the first time, increasing demand for space at data centres. Predicted increases in gaming, video and e-payments in the next few years are also making data centres look like a safe bet and pushing up interest these real assets. In March 2022, KKR and Global Infrastructure Partners completed their acquisition of data centre operator of CyrusOne for USD15bn.

New entrants to the sub-sector should note that the type of data centre as well as the counterparties involved will largely drive the commercial and contractual strategies for data centre development but there are a number of common themes that real estate investors typically consider. These include electricity and power supply, connection, regulatory and permitting issues (such as ESG, see below, and the impact of the Foreign Direct Investment Regulations), data protection, contracting and asset-specific features of data centre financing.

> “Clients are increasingly interested in assets that have a strong wellness and sustainability angle.”

Life sciences

We have also seen growing demand for life sciences facilities across the globe, with the pandemic underscoring the importance of these critical research facilities. This has been particularly evident in China, where the government has been pumping billions into developing a domestic life sciences research and development industry over the past three years. Confidence in the sector was underscored by Warburg Pincus-backed DNE Group’s announcement in April that it was forming a USD1.2bn joint venture to acquire and develop the life science parks in top-tier Chinese cities.

Environmental, Social and Governance (ESG)

Clients are also increasingly interested in assets that have a strong wellness and sustainability angle as tenants look to improve their ESG standing and lure staff back to the office. In New York, the One Vanderbilt and Hudson Yards developments have wooed tenants with air filtration systems, outside space and lower carbon emissions relative to their size than rival buildings. In China, government policies to reduce carbon emissions have also encouraged investors to pour money into greener office buildings. This has allowed such buildings to command premium rents and make them more attractive M&A targets. But ESG terms in leases remain a point of negotiation, with landlords and tenants needing to strike the right balance between improving ESG credentials and avoiding overly onerous data collection.

Staycations

When it comes to leisure, holiday parks have also proved attractive take-over opportunities. In the UK, Covid-19 travel restrictions led to a boom in ‘staycations’, and this year we saw investors respond with a wave of acquisitions in the domestic holiday park market. Over the past 18 months, Bourne Leisure, Park Holidays and Away Resorts have all been the subject of private equity transactions.

Students and seniors

We have also seen continued interest in care homes, senior living facilities and student accommodation, with investors keen to capitalise on an ageing population and rising student numbers across the globe.

Why have these areas seen such interest in recent years? Worldwide investment in student accommodation has doubled over the past several years, with investment in student housing typically being driven by the pursuit of stable cashflows due to the lease terms in line with the annual university periods. Various commercial drivers may be considered by investors.

On the other hand care home leases offer stable long term rent returns for investors because, unlike the increasingly short terms for retail and office leases, care homes across Europe still typically have lease terms of over 20 years. However, some operators may come under strain in the current high-inflationary environment as rent reviews in care home leases are typically index-linked.

Alternative lenders offer innovative structures

The first half of the year also saw a growth in financing provided by non-bank lenders.

Banks become more risk averse on real estate lending during the pandemic, amid concerns over retail and office occupancy rates. But private debt funds, which raised a near record USD39.5bn for real estate deals last year, have stepped into the gap.

Non-bank lenders tend to have a slightly higher risk appetite and offer more innovative debt packages than traditional banks, with mezzanine and preferred equity arrangements now relatively commonplace. Expected rises in interest rates in the next few years are also making the type of longer term, fixed-rate debt that alternative lenders can provide increasingly attractive to borrowers. All of this has made debt funds a useful source of capital for assets that have sustained a short-term hit by the pandemic, but they should be viable bets in the long term.

The growth of growth capital: how will the market develop?

There has been an explosion of interest in the growth capital market in recent years, with numerous new investors raising billions of dollars for investment in earlier stage companies positioned for expansion.

The wall of money looking to invest in growth companies meant that, until relatively recently, high-quality companies with well-respected founders were able to command blockbuster valuations, negotiate more founder friendly terms and even reject investors that were not a good fit for their business.

But a challenging economic environment is shaking up the growth market, we expect that this will lead to the return of more investor friendly deal terms over the coming year.

Wall of money

In light of the impressive returns enjoyed by many growth capital investors in the years following the financial crisis, a new set of players sought opportunities to deploy capital in growth capital companies. This trend was accelerated by the pandemic, which saw technology sector valuations soar, further encouraging investment in this part of the market.

We have seen traditionally conservative corporates adjusting their risk criteria and establishing dedicated venture and growth investing arms, as well as private equity firms raising billions of dollars for stand-alone growth capital funds, while family offices and sovereign wealth funds have also increasingly started investing in growth companies.

But many investors are anticipating a downturn in valuations of growth equity companies over the next year. Companies seeking growth capital typically make no or small profits, but tend to have a proven business concept and product, which with additional investment is likely to become cash-generative and profitable.

With soaring inflation and a squeeze on incomes in many countries, a downturn could affect growth stage businesses disproportionately due to the often cash-hungry business models.

Adjustments to deal terms

Macroeconomic headwinds have already started to move the market back to more investor friendly deal terms, but the effect of the boom means that we still expect further adjustment over the coming twelve months.

As a reminder, the venture capital funds that traditionally dominate this sector have largely followed a relatively standardised set of terms, dominated by the NVCA form in the U.S. or BVCA in the UK. The focus for these investors tends to be on risk mitigation, more protective veto rights and speed of execution. Newer entrants, in particular private equity investors, are often more focused on the upside potential of their investments and ability to direct the destiny of the relevant asset.

Deal terms remain fluid and are worth close monitoring, but we have started to see a number of interesting trends that seem to be driven by the experience and preference of these new investors:

- **Guaranteed returns:** investors are arguing for more of a guaranteed return, not just the downside protection of the liquidation preference. This is manifesting itself in higher preference multiples in some regions or even a preferential payment or dividend, something which would be highly unusual in many markets only a few years ago.
- **More majority transactions:** we are seeing the ownership stakes creep up on many growth equity deals. Minority investment stakes tend to be common in this space, but many private equity firms are looking to take 55% stakes or even higher in growth companies. In such situations the traditional minority investment terms will often need to be re-evaluated.
- **An extension of deal timelines:** we are seeing that as more risk-wary investors enter the market, they require longer to assess targets and agree terms.
- **Veto rights:** where control is not sought, veto and consent rights are becoming more common. During the boom years, founders successfully resisted this trend but as investors perceive greater risk in the market, the demand for these sorts of protections has grown.

Winners and losers

We expect that a downturn will also lead to changes in the types of buyers and sellers operating in the growth capital market.

A downturn could be a boon for private equity investors, who will be keen to snap up growth stage companies at bargain prices. They may also be able to pursue more 'buy and build' strategies, where they merge a number of small companies into a sizeable business. Similarly, we expect that a bear market might push some more risk-averse investors to retreat from growth capital investing and instead focus on assets that are perceived as less risky.

We are also anticipating that growth companies that have already raised capital will likely shift to prolonging runway and considering opportunistic M&A. Competitors in less secure market positions may become tantalising targets for some growth capital companies in certain sectors.

The next 12 months brings many uncertainties but one thing is for sure: growth equity is here to stay and will remain a powerful feature of the private capital landscape for many years to come.

What protections are available to investors on minority deals?

There was a time when many private equity firms would only invest in a business if they could take full control. Not so anymore. Over the past five years, we have seen a marked increase in deals where investors take only partial ownership of a company.

Minority investing offers new opportunities for private equity firms and institutional investors to put money to work in high-performing companies – and we expect these deals to be a permanent fixture of the M&A landscape in the years to come. However, our experience has shown that investors need to take particular care to ensure that their rights are adequately protected throughout the lifecycle of the minority deal.

Hot market

Minority deals happen across a range of different sizes of businesses, investors and sectors. The common thread that runs through all these transactions is a hot deals market, which has made it harder for firms to deploy capital and forced them to look at new types of transactions. The pandemic also made businesses more willing to accept minority investments from external shareholders, as many companies struggled to survive lockdowns and a radically altered trading environment.

There are now a range of private equity firms that target mid-market minority deals, with some even raising stand-alone funds for such transactions. For instance, Inflexion raised GBP1bn for its second 'Partnership Capital' fund in 2018.

Over the past two years, we have seen a particular increase in the popularity of partial exits, where a private equity firm sells down a minority stake in a portfolio company but holds on to the rest. For instance, private equity firm Bridgepoint first sold a minority stake in Element Materials Technology Group Singaporean investor Temasek in 2019, before agreeing to sell the company to it in 2022. We have also seen more prospective buyers use minority stakes as a way to differentiate themselves during competitive auction processes, offering the seller the chance to retain a minority stake in a company rather than fully exiting the business.

Deal levers for minority investors

Minority deals throw up new challenges for private equity firms and institutional investors, who need to find ways to protect their interests throughout the duration of their investment and during the exit process.

From our experience with clients, we have identified a number of levers that enable minority shareholders to exercise control over the deal:

- **Board representation:** The minority investor will typically gain one seat on the portfolio company's board if they own over 15% of the shares. In some transactions the private equity owner may also request a limited amount of control over the management team, for instance being consulted on key C-suite appointments – although this is less common. Sometimes, minority investors can gain more board representation if the company performs poorly.
- **Veto rights:** The minority investor will also typically have a limited set of veto rights when it comes to issues that are material to the business, such as related party transactions or excessive levels of debt financings. However, the minority investor will not usually be able to veto day-to-day managerial issues or key strategic matters, such as changes to the business plan.
- **Exit rights:** How and when an exit occurs is a particularly important issue that needs to be addressed in deal documentation.

  We find that exit rights typically vary based on the investment horizon of the majority owner.

  If the majority owner is a closed-end private equity fund, who typically seeks to exit investments within five years, the minority investor tends to be unable to choose when they sell down their stake. The private equity fund will also usually have 'drag along' rights that can force a minority shareholder to sell their stake when they deem the time is right, thereby allowing a control premium to be realised. The minority investor may also have 'tag along' rights that give them the right to have their shares purchased on the same terms as the majority shareholder.
- If the majority owner is a founder or investor with a longer investing horizon, there tends to be more debate around whether a minority shareholder can independently sell down their position or initiate an IPO. We find in these cases it very much depends on the type of asset and the group of investors. However, the minority investor is often required to give other shareholders a right of first refusal on the sale of their shares.
- **Minimum return protections:** In some instances, minority investors insist on introducing minimum return protections into deal documentation, particularly when investing at a later stage into a well-performing asset. This ensures that the minority investor cannot be forced to sell their stake in a company until they have made a certain return on the deal. Clients often ask us if there are market norms when it comes to typical minimum returns, but it is still very much deal dependent and will alter depending on the return expectations of the investor, the asset and the market conditions.

Protections ever more important

The importance of these different deal levers will alter depending on the type of minority transaction that is occurring, as well as the market context. But with economic headwinds likely to severely affect trading conditions in the year ahead, investors will need to take ever more care to ensure they properly understand what rights they may or may not have in a wide range of circumstances.

Growth of ‘core plus’ infrastructure investing puts spotlight on diligence and deal terms

The evolution from core to core plus investment is changing the asset class.

Over the past ten years the types of assets that infrastructure investors have been willing to buy has been steadily widening, with the race to Net Zero, the war in Ukraine and the pandemic only accelerating this trend. These assets provide interesting opportunities for investors but their higher risk profile means that investors need to take a different approach to due diligence as well as consider new financing terms.

Market transformation

Before the financial crisis, infrastructure investing was dominated by pension funds and institutional investors who tended to only purchase ‘core’ assets, such as gas or electric providers, water companies, top-tier airports and seaports. But in recent years a new generation of investors has entered the space, pushing up prices and forcing investors to look at more unconventional infrastructure plays. Investments in assets such as motorway services stations, data centres, fibre optic networks, stadiums and hospitals are now far more common, with the industry terming these ‘value add’ or ‘core plus’ infrastructure investments.

In Asia Pacific in recent years we have seen Canadian pension funds, Middle Eastern sovereign wealth funds and alternatives players, like KKR and Stonepeak, building out their infrastructure teams, while in the U.S. and Europe, we have seen a rise in the number of Australian superannuation funds on the hunt for deals, with Aware Super saying that it would spend AUD16bn on assets in these regions in the next three years.

> "Global lockdowns reduced revenue streams from core infrastructure assets like airports and toll roads, encouraging investors to diversify their strategy and look to digital infrastructure assets."

Rising awareness about the impact of climate change as well as the pandemic is furthering this trend. Global lockdowns reduced revenue streams from core infrastructure assets like airports and toll roads, encouraging investors to diversify their strategy and look to digital infrastructure assets. As such, we have seen a race for data centres across Europe and Asia Pacific, with a scarcity of land and power supply remaining issues for further growth in Europe. We have also seen rising interest in fibre optic networks, which in parts of Europe, including Germany, is lagging behind the U.S. and Asia.

Over the past two years we have also seen a huge increase in interest in solar and wind assets, as well as for other assets that will be crucial to the energy transition, such as transmission, storage, distributed energy and clean mobility. We have seen a rising interest in platform deals from a range of investors in this area, with developers and utility companies now bundling together portfolios of these assets to entice larger infrastructure investors to invest. As Europe attempts to wean itself off Russian oil and gas, we expect ever more demand for these sorts of infrastructure investments over the coming years, particularly given that a record USD26bn was raised for renewables strategies last year, according to Infrastructure Investor magazine.

Due diligence

This market transformation requires buyers to take a different approach to due diligence. While a core infrastructure asset might rely on regulated contracts with a government agency for its income, a core plus asset might instead be dependent on long-term contracts with private sector organisations. As such, buyers will need to adopt a more holistic approach to due diligence, ensuring that contracts in place are robust and will provide reliable revenue streams. In some instances this will involve surveying a small percentage of thousands of contracts that may be in place. In other instances, it will involve lawyers doing a deep, granular dive of all the customer contracts. The requirements will depend on the situation.

Changing financing terms

The entrance of more private equity players into the infrastructure market has also encouraged many investors to take advantage of more flexible financing arrangements that are typically seen on leveraged buyouts.

Over the past two years we have seen a wide range of more investors pushing for:

- Increasingly borrower friendly lending terms, such as the ability to increase debt levels or reschedule payments with the permission of only one lender.
- Greater flexibility when it comes to the financing of bolt-on acquisitions, with fewer restrictions on how much and when they can borrow money for follow-on M&A.
- More restrictions on whether debt can be sold on to a third party, such as a hedge fund or other private equity firm, in the event of default.

In Asia Pacific, new entrants to the market are also bringing more sophisticated funding approaches, increasing the desire for warranty and indemnity insurance coverage.

Changing leverage levels

In addition to these more private equity style financing terms, we have also seen a change to the leverage levels on some core plus deals. For instance on large cap deals, where the investor is essentially buying a company with a balance sheet and track record, we regularly see leverage levels of five to six turns of EBITDA – similar to a traditional private equity deal. On a traditional project finance deal it is not uncommon to see up to ten times of leverage.

These changing market dynamics mean that investors now have more flexibility than ever when it comes to the types of assets they buy and financing available to them. But those changes also carry risks, requiring careful consideration from both buyers and sellers.

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