EVALUESERVE

Global M&A Outlook – Amid Coronavirus

The global market has been heavily impacted due to the COVID-19 pandemic, disrupting M&A trends across sectors.

Announced global M&A deal volume reduced 34% on a YoY basis to $780 billion as of April 23, 2020, and is most likely to continue declining through the second quarter.

Industry Intelligence: Views on the impact, implications and risks across Global M&A Market due to COVID-19

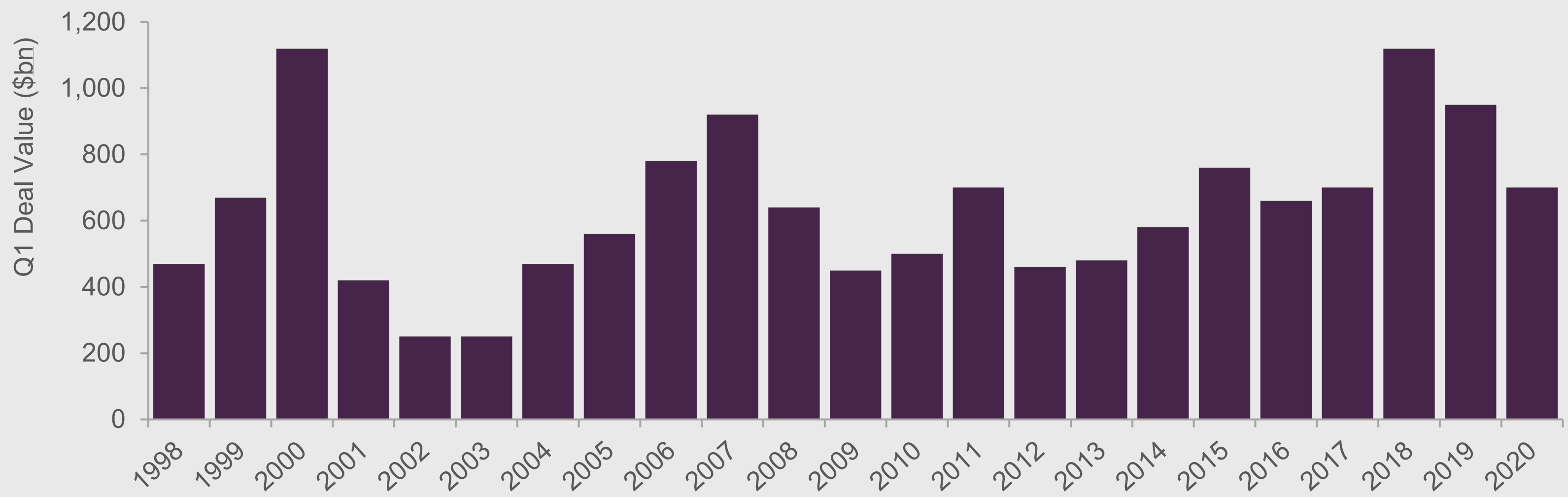
1. Global M&A Industry: The Story So Far (1)

The global market has been heavily impacted due to the COVID-19 pandemic, disrupting M&A trends across sectors. The announced global M&A deal volume reduced 34% on a YoY basis to $780 billion as of April 23, 2020 and is most likely to continue declining through the second quarter. In April 2020, $69 billion worth of deals were announced globally, which is down by 72% as compared to March 2020 and lowest monthly total since September 2002. The pandemic has impacted cross-border activity the most, with just $18.4 billion worth of deals in April 2020 which is down by 67% from March 2020, lowest monthly total since February 2002.

As of 23rd April 2020, while YTD announced M&A volume in North America was down 55% to $277 billion, the announced M&A volume in Europe was up by 35% to $236.7 billion, with strong deal activity from Russia, Germany, UK and France. The increase in announced M&A deals in Europe is primarily because of some of the large multi-billion-dollar deals announced in the Q1 2020 including $39.6 billion stake sale for Sberbank in Russia and the $30.1 billion merger of Aon and Willis Tower Watson. In fact, of the top 10 deals announced in Q1 2020, five of them involve a European player. It remains to be seen whether these large deals will get completed as per their timelines in the current situation. However, it looks like that M&A in Europe is also tapering off. While Q1 2020 YTD, Europe announced volume was up 120%, but the number of announced deals was down 18%. Further if we look at the corresponding data for year to 23rd April, the announced volume was up only 35% and the number of deals announced was down ~30%, indicating that April 2020 was a slow month for European M&A.

APAC (ex-Japan) is down by 5% versus last year, but with economic activity in China picking up over the last few weeks and other Asian countries showing improving trends in fighting COVID-19, the M&A activity in APAC should stabilize over the next few months.

Global M&A Volumes Plunge



Primary reasons for the decline

- Travel restrictions have halted negotiations, management presentations, and visits to client sites.
- Securing debt financing is difficult in the current times.
- Changes in the valuation of target companies due to the negative effects of the pandemic (this will re-open purchase price discussions).
- Longer cycle time for closing of deals due to paperwork, clearance, consents, and approvals.
- More Buyers within ongoing deals are exercising The Material Adverse Change (MAC) Clause, which allows them to cancel the deal if the target is impacted by contractually defined force majeure events.

(1) All M&A related stats are sourced from Refinitiv Deals Intelligence Reports

2. Impact on Ongoing M&A Deals

The current situation has disrupted M&A activities globally. One of the big deals that fell through due to the pandemic was Xerox's hostile takeover of HP; the deal was estimated to be around $35 billion. Launched in early March, the deal lapsed by the end of the month due to market uncertainties and the company's concern for upcoming cash crunch. Other noticeable deals that were withdrawn / delayed in recent months include the following:

- Gray Television's acquisition of Tegna for $8.5 billion; although Gray television has withdrawn its offer, two other investors Byron Allen and a consortium led by private investment firm Najafi Companies and Trinity Broadcasting Network have submitted bids of similar amount subsequently, but they are yet to proceed further on this.
- Woodward's acquisition of Hexcel for $6.4 billion was mutually terminated by both the parties in response to the increasing impact on both the aerospace and industrial sectors.
- UK-based Cineworld's acquisition of Canada-based competitor Cineplex for $2.1 billion is in rough waters as group of Cineworld lenders are planning to block the company's debt-fueled takeover of a Cineplex.
- Alimentation Couche-Tard's $5.6 billion acquisition of petrol station operator Caltex Australia was cancelled as Alimentation Couche-Tard decided not to proceed with a takeover bid due to economic uncertainties posed by Coronavirus. The acquirer further stated that it may re-engage with the Caltex once there is sufficient clarity on the global outlook.
- Boeing's $4.2 billion acquisition of Embraer's commercial jets division was cancelled by Boeing to conserve its cash reserves and overcome the impact of Coronavirus on aviation industry and drop in travel preferences.
- Sycamore Partners has called off $525 million deal to acquire a majority stake in the L Brands' Victoria's Secret and PINK lingerie brand citing the worldwide closure of nearly all 1,600 stores occurred (due to Coronavirus outbreak) without its permission and thereby the terms of the deal were violated.

Despite this, some recent large deals have also been announced:

1. Facebook acquiring a 9.9% stake in Jio for $6.7 billion to get a stronger footprint in India.
2. SoFi acquiring Galileo Financial Technologies for $1.2 billion to strengthen its capabilities further.
3. Total agreeing to buy Tullow Oil's entire stake in jointly-held onshore oil fields in Uganda for $575 million.
4. KKR purchasing convertible preferred stock of US Foods Holding Corp. for $500 million to support the company in the current difficult environment.
5. Altice Europe divesting a stake of ~50% in its Portuguese fibre network to Morgan Stanley Infrastructure Partners for around $2.5 billion.
6. Telefonica to sell its ~10,000 German cellphone towers in Germany for $1.6 billion to Telxius.
7. Imperial Brands selling its worldwide premium cigar business for $1.3 billion to a consortium of individual investors.
8. Takeda selling its OTC and prescription pharmaceutical business and certain manufacturing plants in Europe to Orifarm for $670 million.

Based on the deals that have been announced, it looks like companies that are still pursuing M&A are either those with deep cash pockets, looking to divest non-core assets to improve their performance or to reduce their debt burden.

3. Regulatory Impact across Geographies

Regulatory authorities are becoming stricter, resulting in longer deal closure cycles and delays in approvals.

- US and Canadian transactions were already subject to Competition Act and/or HSR Act approvals. In addition, Federal and Government bodies are changing their work style in response to the pandemic like - accepting electronic documents only as oppose to hard copies and extending review deadlines by 30 day for some of the ongoing mergers.
- EU regulators have also asked companies to delay M&A antitrust filings (merger notifications to both the Federal Trade Commission and the Department of Justice).
- Spain has also imposed new rules on FDIs. Investors outside the EU now need to obtain new authorization if they wish to control or increase their participation to more than 10% in a local company, be it public or private, in a strategic sector.
- Italy has announced measures to strengthen the "golden power" to protect from foreign takeovers by adding sectors like banking, insurance, energy, and healthcare under its purview along with any EU companies looking to purchase more than 10% stake
- Germany is also planning to block deals that present "potential interference" to its interests. It aims to protect local companies from takeovers by entities based outside the EU.
- The Australian government will also be closely monitoring all incoming acquisitions (cross-border) and all foreign investments will require Foreign Investment Review Board (FIRB) approval.
- The Indian government also amended its FDI policy to discourage opportunistic investment by neighboring countries in domestic companies. As per the new amendment, FDI investments from India's neighboring countries will now require approval from the government.

Apart from this, central banks and other regulating authorities across the globe have taken significant steps to support and protect businesses that are trying to cope up with restrictions imposed due to the outbreak.

- The US Federal Reserve has cut interest rates twice and ramped up its quantitative easing. It has also announced a stimulus package (PPP) of $2 trillion. The package will allocate $350 billion in loans to small businesses to help keep them afloat. It will also give $100 billion to help hospitals that are either struggling to cope with the influx of patients or braced for a surge in coronavirus patients. The government will also provide a $500 billion fund, which includes $25 billion for passenger airlines, $ 4billion for cargo carries among other industries, and $454 billion for the Federal Reserve to leverage businesses, states and municipalities. The US government is already in talks with advisers like PJT Partners, Moelis and Perella Weinberg to manage the bailout package.
- The government of Canada has announced an interest-free loan of $40,000 for non-for-profit businesses, funded from its $25 billion Canada Emergency Business Account (CEBA) program.
- The Reserve Bank of Australia has cut its interest rates twice in the first quarter of 2020. The Australian government has also introduced schemes for SMEs to avail unsecured loans.
- The UK government has introduced financing facilities of up to £5 million for smaller businesses experiencing cash flow disruption and loss of earnings.
- China has introduced a targeted cut in the reserve requirement ratio (RRR) to help small businesses that are facing cash shortage.

Based on what we have seen so far:

- Governments are bringing in polices to protect domestic companies and safeguard them from predatory buyers, leading to fewer deals and more time consumed on regulatory scrutiny.
- Governments are bringing out rescue packages to not only help small businesses, but also large but essential businesses like airlines, cargo etc. to help them out during these times. They are also exploring the idea of placing restriction on large companies receiving these bailout packages like - limits on senior management pay, no dividend payments and no stock buybacks.
- Globally, private sector banks have started acting as a channel for Government aid. In the US, almost all prominent banks including giants like - Wells Fargo & Bank of America are distributing loans under PPP.

4. Accumulation of Stakes in Companies

The current crisis can also be seen as a great opportunity for stock market investors and big corporations accumulating stakes in their small counterparts. Companies have started to ask investment banks for good investments and opportunities to deploy their funds in stocks that are trading below their valuations. Recently, the People's Bank of China increased its stake in an Indian company, HDFC Bank, to 1.01%. HDFC's stock is trading ~40% below its 52-week high. Chinese state-backed investment fund, CNIC Corp., is also considering buying about a 10% stake in Greenko Group, an Indian company in the renewable energy sector.

Saudi Arabia's sovereign wealth fund, the Public Investment Fund (PIF), has accumulated stakes worth $1 billion in four major European oil companies: Royal Dutch Shell, France's Total, Norway's Equinor, and Italy's Eni. PIF's purchases come during a global oil and gas industry downturn, as demand has fallen sharply due to the coronavirus outbreak.

In another example, China's state-owned company China Reform Holdings' bid to dominate the board of Imagination Technology Group plc (Imagination), a UK-based smartphone chip manufacturer, and was blocked by UK legislators as the deal would have given the company, and by extension the Chinese government, complete control over Imagination.

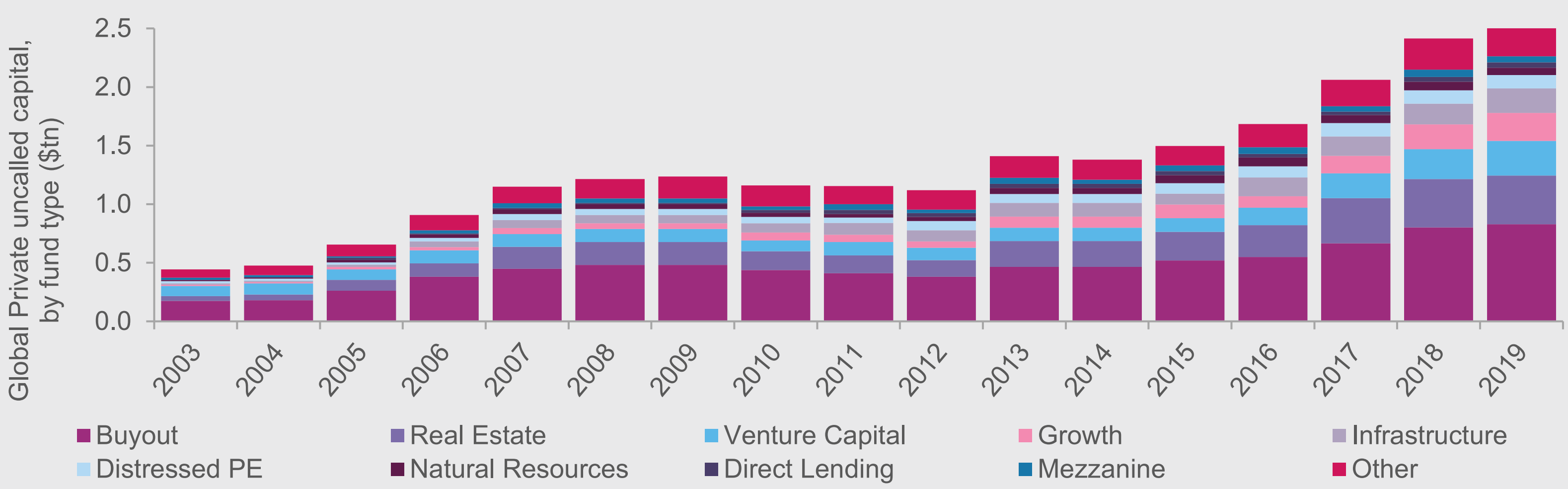
As the trend of stake accumulation becomes common, the distinction between the country's interest vs shareholder interest will become more evident. The dilemma here is that Imagination will not be the only company vulnerable to foreign investment. A lot of companies might be excepting such bids under the current scenario and their governments may choose not to intervene.

Another variable to this equation would be shareholder activists. However, the role they play in this scenario and how much say they will have in decision making would depend on their stock representation.

5. Divestments and Opportunities for PE Firms

Companies regularly review their portfolios to identify areas of growth and underperformance. This also enables them to be prepared for divestment / reinvestment. Divesting stressed / distressed assets will be a typical trend during the current crisis to raise capital. In addition, companies are looking for opportunities. Private equity (PE) firms are cash-rich and might get good deals in companies looking for cash to survive in the current market. PE firms are also looking for companies that have the potential to thrive in a post-COVID-19 scenario. According to Refinitiv, 15% of the M&A activity in Q1 2020 was due to private equity-backed buyouts. While private-equity backed deals decreased by 22% versus Q1 2019, this level of activity is still the highest percentage of private equity backed deals in total M&A since Q1 2013.

Private Equity has Record-Sized Piles of Cash to Spend



Sources: Preqin and Bain & Company

6. Opportunity in Restructuring and Bankruptcy Advisory

Despite the stimulus being injected into the system by the government, a substantial number of companies can fall during the current downturn. Corporations across industries are facing liquidity and financing concerns and are opting for restructuring.

Some examples within the US are:

- Freedom Mortgage is looking for additional financing, as millions of homeowners are expected to stop making mortgage payments.
- The Cheesecake Factory may seek restructuring help, as it would not be able to pay rent because of lost business.
- Giant companies, such as Kraft Heinz and Ford, have already secured billions of dollars in credit from banks, in preparation for an uncertain future.
- Cruising Company Carnival has taken up a $3 billion credit line, is looking for more financing.
- Alaska Air has borrowed around $425 million, securitized by its aircraft.

Several private equity and hedge fund firms, including Fortress, Apollo, and Avenue Capital, are planning to finance companies with riskier debt profiles at higher interest rates.

7. The Positive Side

Global companies continue to plan major transformation programs. As per one of the surveys conducted by EY in March 2020, 56% of the executives globally are opting to transform through transactions and are planning an acquisition in the next 12 months. So far this year, deals worth $24,131 million have been announced globally in the fintech sector, an industry record for the YTD period.

As per Dechert, M&A activity will increase gradually in H2 2020, as Chinese companies would try to invest in APAC and abroad. Deal activity in industries, such as consumer products, travel, and hospitality, would bounce back when things return to normal.

Chinese firms are getting ready for discount deals in Europe. Bankers have recently seen a spike in requests from Chinese firms and funds for proposals on targets in Europe. Chinese conglomerate Fosun International Ltd. stated that it will look for investment opportunities around the world as the “once-in-a-century” coronavirus pandemic sparks an asset-price downturn.

As per UBS, European companies are gearing up to resume acquisitions and IPOs in the second half of 2020. As per the bank, M&A activity will revive as companies with strong fundamentals will try to grow their businesses through deals. They will do so to benefit from lower prices, while those who have been hit by the crisis will try to prevent hostile takeovers. The investment bank has already noticed an increase in activity since the beginning of April, indicating strong investor interest.

All these indications point towards markets bouncing back once we have left this outbreak behind us. Despite the uncertainties we are facing currently there seems to be a good reason for us to look ahead with hope, thanks to the resilient and tactful investors and market preparedness.

