M&A monitor

Deal-making rebounds | The evolution of SPACs | Life after the US election

Q3 2020

Freshfields Bruckhaus Deringer

Life returns to the M&A market

After six months of gloom, Q3's M&A data offers a glimmer of hope. Quarterly deal value rose for the first time this year, with $786bn of transactions announced between July and September, $346bn more than between April and June.

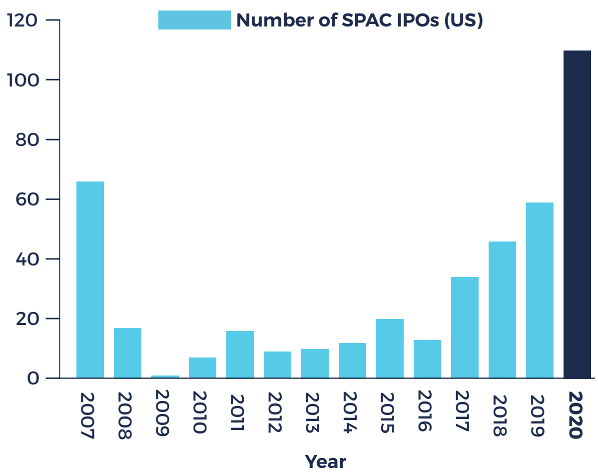
The total for Q3 even outstrips the corresponding period last year, with the increase from Q2 tracking the beginning of the economic recovery that has followed the easing of lockdown restrictions around the world.

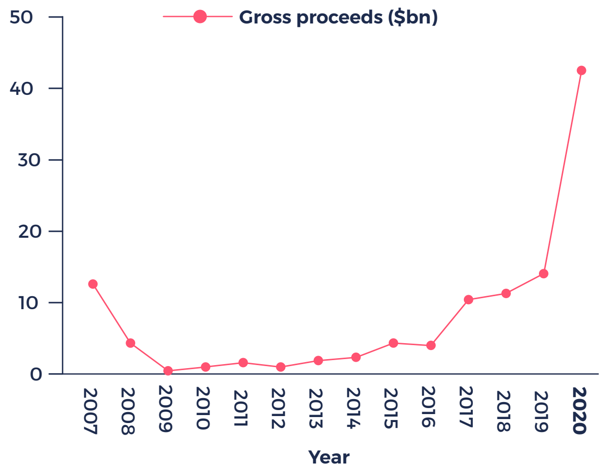
There was a resurgence in big-ticket deals across the quarter, with 10 $10bn+ acquisitions, including one over $40bn. US corporates and sponsors were responsible for seven of the 10, with activity among US buyers increasing almost fivefold between Q2 and Q3 from $76bn to $358bn.

TMT was the most active sector (as it has been for six of the last seven quarters), accounting for more than 40 per cent of activity by value and 28 per cent by volume. 7-Eleven's $21bn buyout of US gas station and convenience store chain Speedway pushed consumer and retail into second place in the value table, followed by industrials and healthcare. After being such a strong performer in recent years the latter has dropped to sixth position for 2020 overall, reflecting the dearth of mega-mergers that have come to define healthcare M&A.

Are SPACs here to stay?

Barely a day goes by without another special purpose acquisition company (SPAC) hitting the headlines. 2020 has already smashed the record for the number of SPACs launched in a calendar year, and the amount raised in SPAC IPOs had surpassed the previous 12-month high before the end of June.





Source: SPAC Analytics. Data correct to 25 September

With stocks so volatile during the early weeks of the COVID-19 crisis, SPACs were suddenly the hottest story in town. That's because – alongside the benefits of tapping into brand-name SPAC sponsors' deep market and/or industry experience – they offer companies a faster and more predictable way to go public. Founders negotiate with the SPAC and its sponsors to lock in the price they'll receive for the business *before* registering to become a public company and executing the merger (as compared to a traditional IPO where the company registers *first* and only *then* markets and prices its shares, a process that normally takes much longer). The true value of a company once it merges with a SPAC is obviously dependent on aftermarket trading, but it's all but impossible for founders to predict an exit price at the start of an IPO process during times of extreme market uncertainty.

Fast forward to mid-2020 and SPACs remain in full swing, despite the equity markets firing again (albeit with underlying volatility). Whether they stick around may depend on whether more founders follow in the footsteps of Bill Ackman, whose $4bn Pershing Square Tontine was the biggest ever SPAC IPO when it launched in July. The deal was notable because Ackman eschewed the sort of sponsor-friendly equity and warrants package that has historically defined SPAC vehicles, giving the owners of Ackman's M&A targets more economic reason to consider a merger even though stocks are rising.

Today's SPACs will also need to perform better than previous iterations if they're to remain attractive to investors. While there have been some notable recent successes (DraftKings, Clarivate), it cannot be ignored that SPACs' five-year rate of return is a shocking minus 18.8 per cent. Simply investing in the S&P 500 (for example through an ETF) over the same period would have generated a more than 50 per cent return, with LBO and VC funds delivering more than 10 per cent.

Asset	5Y ROR (%)
SPAC	-18.8
LBO fund	16.2
Venture capital (early-stage) fund	10.2
Actively managed hedge fund	1.8
S&P 500	56.9

Source: Renaissance Capital, Preqin, Bloomberg, Capital IQ

Pamela Marcogliese, a capital markets partner in Freshfields' Silicon Valley office who has advised on some of the biggest recent SPAC deals, says: 'Boards who are looking to raise equity capital could choose a traditional IPO, a direct listing or a SPAC merger. SPAC deals had historically prevailed when the markets were challenging. But if we start to see terms shift in favour of target companies, they could stay in play, particularly as they present certain advantages over traditional IPOs.'

Sarah Solum, Freshfields' Silicon Valley managing partner, who, like Pamela, has a long track record advising on equity capital markets deals, adds: 'With more options available to companies, we're likely to see more listings. Boards still have to weigh whether going public is the right choice for them and, if so, how they're going to do it, because each model has different strengths. A traditional IPO might be best for a company looking for support from a syndicate of underwriters and the opportunity to do in-depth education with research analysts. Direct listings appeal to businesses that are confident in their ability to garner attention from investors and analysts, and who place a premium on market-based pricing. SPACs present the advantage of speed to market and valuation certainty. With so many SPACs around right now, boards are getting lots of approaches to do deals.'

SPACs: a primer

SPACs are corporate entities that float on some public markets (they are permitted in New York and London, for example, but not in Hong Kong) to raise money for M&A. They are typically established by deal professionals with a personal brand or are affiliated with investor groups with a track record of success.

They list by issuing 'units' consisting of one common share and a whole (or fraction) of a warrant to buy an additional share of the SPAC after a business combination has taken place.

Although terms can vary from deal to deal, sponsors typically inject their own capital by buying warrants via a private placement, and also benefit from being able to buy 'sponsor shares' (around 20 per cent of the common shares after the IPO) for a nominal fee.

Sometimes, SPAC transactions are accompanied by additional capital from PIPE investors.

In the US, SPACs enable the public to participate in private equity-style transactions safe in the knowledge that if the sponsors are unable to find a target within a set period (typically two years), they get their money back. Even if the SPAC identifies an asset to acquire, public investors can cash out at closing if they choose.

For more on SPACs, read our blog post here.

Beware of the SPACtivists

In 2008 – when SPACs were emerging from another golden period – they became a target for activists.

SPAC mergers require shareholder approval, so activists (many with a history of activism in closed-end funds) took to buying shares in SPACs that were trading below the value of their IPO proceeds and voting to block their proposed deals. This would force the SPAC into liquidation, at which point the activist's stock would convert into a proportionate share of the IPO cash (which is held in a trust account until the merger closes), and they would emerge with a profit. Today's SPAC structures are evolving to mitigate this risk, with shareholder voting rights modified to make it harder to block deals, the right to vote 'no' separated from the right to redeem shares for cash, and restrictions on stockholders selling more than a certain percentage of their shares to guard against activists accumulating large positions.

What does the US election mean for deals?

As we head towards November's presidential election, thoughts are turning to how the result could affect relations with China – and by extension global M&A.

The battle for geopolitical and economic supremacy – and how that reads across into trade and foreign investment – will remain a priority under a second Trump administration. Comparing the current presidency with Barack Obama's final term unsurprisingly shows that Chinese inbound investment has dropped by a massive 63 per cent over the past four years. However, these numbers say as much about the amount of Chinese money (driven by Beijing's newly announced five-year plan) flowing into the US between 2013 and 2016 as they do the impact of restrictions imposed by the US since then. This point is crystallised when you set M&A data for the past four years alongside figures from President Obama's *first* term – which shows that Chinese investment in US assets has *more than doubled* under Trump with an entire quarter of 2020 still to run.

	Obama's second term (Q1 2013–Q4 2016)	Trump's first term (Q1 2017–Q3 2020)	% change
Total M&A (volume)	34,730	36,762	6
Total M&A (value – $bn)	4,481.70	4,479.95	0
Inbound M&A (volume)	6,551	9,037	38
Inbound M&A (value – $bn)	1,322.16	923.32	-30
Chinese M&A (volume)	381	350	-8
Chinese M&A (value – $bn)	85.01	31.32	-63

	Obama's first term (Q1 2009–Q4 2012)	Trump's first term (Q1 2017–Q3 2020)	% change
Total M&A (volume)	28,116	36,762	31
Total M&A (value – $bn)	2,731.29	4,479.95	64
Inbound M&A (volume)	5,181	9,037	74
Inbound M&A (value – $bn)	601.44	923.32	54
Chinese M&A (volume)	226	350	55
Chinese M&A (value – $bn)	14.58	31.32	115

Source: Refinitiv. Data correct to 25 September

The TikTok situation shows just how rancorous Sino–US relations have become, but analysts are not expecting a significant thaw even if there's a change of occupant in the Oval Office. Joe Biden is considered by many a China hawk, and there remains bipartisan concern in Congress about the security implications of Chinese investment in US strategic assets.

Indeed, if President Trump loses, we may see other countries adopt a more hard-line position towards Beijing. As vice president to Barack Obama, Senator Biden was one of the architects of the Iran nuclear sanctions programme, widely seen as one of the most effective recent exercises in international consensus-building. If he becomes president, it's possible he could use this experience to bring America's traditional allies in line behind US efforts to disrupt China's plans. With China recently announcing its own restrictions on 'unreliable' foreign entities, any escalation could have a chilling effect on global commerce.

As far as other US matters are concerned, a Biden presidency would usher in a change in leadership at the Antitrust Division of the Department of Justice, which would likely result in a more predictable approach to deal approvals. Biden has also pledged to reverse key elements of the Tax Cuts and Jobs Act, increasing levies on corporations and private equity sponsors.

There is, of course, the potential for November's outcome to be disputed, which would affect deal-making far beyond US shores. And with states including California and New York (whose economies are larger than most countries') facing crushing fiscal shortfalls, we could be set for continued volatility for some time to come.

States intervene in European deals

November's US election result will cast ripples across the Atlantic, with Franco/US trade tensions implicated in LVMH's decision to scrap its $16.6bn buyout of luxury jeweller Tiffany. The LVMH board invoked a letter from French foreign minister Jean-Yves Le Drian when they walked away from the deal, with the missive requesting a delay until after 6 January 2021 – the date when President Trump (election permitting) has promised to start levying customs duties on French luxury goods over France's decision to introduce a digital services tax. Tiffany responded by filing a suit against LVMH in Delaware, claiming Bernard Arnault has been trying to break the agreement since the coronavirus struck.

The story took a twist in late September when M. Le Drian told parliament his letter was in response to a question from LVMH, although he confirmed the communication was normal in the circumstances and well-founded. LVMH's countersuit argues that, alongside the minister's request, there was no pandemic carve-out in the deal's material adverse change clause and that Tiffany failed to 'behave as usual' in line with the contract (notably by paying the highest possible dividend during the COVID-19 crisis). The case has been fast-tracked to January, although whether the parties will reach an agreement before it gets that far remains to be seen.

The Italian government's decision in August to gatecrash the sale of Telecom Italia's secondary network to KKR was a more domestic affair but equally startling nevertheless. Deal-makers say they cannot recall an administration intervening in a transaction so late in the day (the government delivered a letter requesting a one-month moratorium to the board meeting where the parties were signing the agreement), and while the transaction is now going ahead, the interruption worked. The government urged Telecom Italia to revisit a possible merger with rival broadband provider Open Fiber, which is jointly run by state-owned utility Enel and the national lender Cassa Depositi e Prestiti. When it eventually signed the deal with KKR at the start of September, Telecom Italia also announced it had agreed to talks with CDP's board with a view to ensuring the latter has a significant presence in Italy's future broadband company.

Other themes we're tracking

Q3 has seen the return of '**zombie deals**', transactions that have lain dormant through the pandemic only to be reanimated by the recent economic upswing. We're seeing renewed aggression among buyers as market uncertainty recedes, and sellers who are prepared to listen. Looking ahead, conditions look primed for a rise in **mergers of equals** (antitrust approvals permitting) as corporates seek scale to ride out the storm.

Linked to this trend, we're monitoring whether **valuation gaps** between parties will be bridged with **deferred value instruments** such as contingent value rights (CVRs) and earn-outs, or whether sellers will continue to dictate terms amid a dearth of quality assets.

And seller deal leverage will only be buttressed by the surge in SPACs – which shows there's still plenty of **capital available for M&A**, especially when you take into account the continued availability of inexpensive debt to fund leveraged buyouts. **Fundless sponsors**, who can be thought of as SPACs in reverse (ie they seek deal opportunities before raising investment), are also on the rise.

Global M&A
Q3 2020 activity by sector

Sector		Value $bn	%
1	TMT	315.9	40.21
2	Consumer*	118.3	15.06
3	Industrials and materials	82.5	10.50
4	Healthcare	82.3	10.48
5	Energy and power	72.1	9.18
6	Financials	64.6	8.22
7	Real estate	40.1	5.11
8	Infrastructure and transport	9.9	1.26
Total		**785.6**	**100**

* Includes retail

Sector		Volume	%
1	TMT	2,736	28.29
2	Consumer*	1,993	20.61
3	Industrials and materials	1,750	18.10
4	Financials	943	9.75
5	Healthcare	824	8.52
6	Energy and power	609	6.30
7	Real estate	575	5.95
8	Infrastructure and transport	240	2.48
Total		**9,670**	**100**

* Includes retail

Global M&A Q3 2020 – value and volume

Global*

M&A value **$785.6bn**

M&A deal volume **9,670**

Top 3 deals	
1 Arm/Nvidia Corp	$40bn
2 Speedway/7-Eleven	$21bn
3 Maxim Integrated Products/ Analog Devices	$20.7bn

Inbound: most targeted markets	
US 2,596 deals	$358bn
China 1,548 deals	$96bn
UK 434 deals	$59bn

Outbound: most acquisitive markets	
US 2,431 deals	$395bn
China 1,492 deals	$86bn
Luxembourg 46 deals	$45bn

USA*†

M&A value **$358bn**

M&A deal volume **2,447**

Top 3 deals	
1 Speedway/7-Eleven	$21bn
2 Maxim Integrated Products/ Analog Devices	$20.7bn
3 Immunomedics/ Gilead Sciences	$19.8bn

Inbound: markets investing into US companies	
US 1,926 deals	$308bn
Germany 22 deals	$17bn
UK 51 deals	$7bn

Outbound: markets US companies are investing into	
US 1,926 deals	$308bn
UK 52 deals	$41bn
Canada 75 deals	$12bn

Europe*†

M&A value **$189bn**

M&A deal volume **2,109**

Top 3 deals	
1 Arm/Nvidia Corp	$40bn
2 eBay Classifieds Holding/ Adevinta	$8.8bn
3 Sunrise Communications/ Liberty Global	$7.3bn

Inbound: markets investing into European companies	
US 155 deals	$54bn
Luxembourg 31 deals	$45bn
UK 329 deals	$18bn

Outbound: markets European companies are investing into	
France 180 deals	$50bn
US 127 deals	$36bn
Netherlands 79 deals	$11bn

Asia-Pacific*†

M&A value **$189bn**

M&A deal volume **3,560**

Top 3 deals	
1 Nipsea/Nippon Paint Holdings	$9.9bn
2 China Oil & Gas Pipeline Network/An investor group comprising Silk Road Fund and China Insurance Investment	$7.9bn
3 Jio Platforms/ Google International	$4.5bn

Inbound: markets investing into Asia-Pacific companies	
China 1,441 deals	$85bn
Japan 631 deals	$33bn
US 77 deals	$17bn

Outbound: markets Asia-Pacific companies are investing into	
China 1,477 deals	$89bn
Japan 599 deals	$19bn
Singapore 55 deals	$15bn

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

1. **$17.3bn** – Livongo Health/ Teladoc Health
2. **$7.9bn** – China Pipeline Network/ An investor group††
3. **$6.5bn** – G4S/Garda World Security Corp

* Deal value includes net debt of target | † Includes domestic deals | Source: Refinitiv | Data correct to 23 September 2020

††China Oil & Gas Pipeline Network/An investor group comprising Silk Road Fund and China Insurance Investment