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M&A Outlook 2021

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Global mergers & acquisition (M&A) volumes fell sharply in the first half (H1) of 2020. While that was not surprising, what turned heads was the spiked recovery in the second half (H2) of 2020. It is interesting to trace this journey from businesses trying to salvage what was left after the pandemic shook the ground to the large strategic transactions and investments. In this article, we look at underlying political and economic factors driving the global investment banking industry, with a closer look at the U.S., Europe, Middle East and North America (MENA), and Asia-Pacific (APAC). Analyzing trends evolving in 2020, we try to discuss the outlook for 2021.

Global M&A Tailwinds

While every region has its unique set of factors coming together to drive trends and their respective impact on various industries, some themes evolve globally and create a wave of M&A. Below are some of the major ones we discuss:

1. **Valuations are at an all-time high.**

   In an M&A piece, it is essential to understand where the global market stands in terms of asset valuations. Global market indicators tell us the enthusiasm in the investors and the outlook for overall economic development. However, as I say this, there is a deluge of articles highlighting how markets and the economy seem to have a lower correlation with each passing day. [1] [2] Even as the global GDP forecasts only go south, the market loves North. Nonetheless, there is merit in knowing market valuations, as it directly impacts a transaction and its attractiveness to the business and its investor.

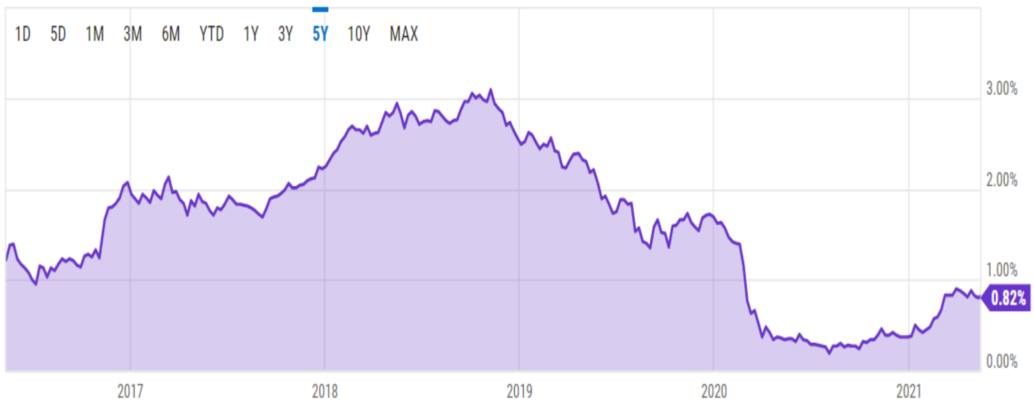
   We use the below parameters to study and gauge valuation:

[1] https://www.cnbc.com/2020/06/03/understanding-the-huge-disconnect-between-the-stock-market-and-economy.html

[2] https://fivethirtyeight.com/features/the-economy-is-a-mess-so-why-isnt-the-stock-market/

a. <u>Bond yields (Treasury, Junk Bonds, and Investment Grade):</u> Falling bond yields make equity markets more attractive. There is more money chasing less, thereby driving equity valuation upwards. An environment of falling yields serves as a fertile ground for stock deals as expensive stock is an excellent currency for purchasing smaller companies. Figure 1 shows US Treasury yields for the past 5 years. The yields have been falling consistently since 2019 before witnessing some recovery from January 2021 onwards.

Figure 1: US Treasury Yields



Source: https://ycharts.com/indicators/5_year_treasury_rate

Figure 2 shows rising bond prices across Corporate, Investment Grade, & Junk bond classes (the table is as of 12 February 2021).

Figure 2: Bond Prices and Returns (as of February 12, 2021)

					YIELD (%), 52-WEEK RANGE			SPREAD, 52 WEEK RANGE		
	CLOSE	% CHG	YTD TOTAL RETURN	52-WK % CHG	LATEST	LOW	HIGH	LATEST	LOW	HIGH
Broad Market Bloomberg Barclays Indices										
U.S. Government/Credit	2647.37	-0.35	-1.69	4.99	**1.220**	1.020	2.160	39.00	39.00	132.00
U.S. Aggregate	2262.57	-0.29	-1.23	4.44	**1.240**	1.020	2.310	34.00	32.00	127.00
U.S. Corporate Indexes Bloomberg Barclays Indices										
U.S. Corporate	3395.05	-0.40	-1.84	5.55	**1.900**	1.740	4.580	92.00	91.00	373.00
Intermediate	3101.82	-0.12	-0.38	5.67	**1.180**	1.080	4.400	65.00	65.00	381.00
Long-term	4974.86	-0.86	-4.13	5.23	**3.080**	2.730	4.930	134.00	134.00	359.00
Double-A-rated (AA)	682.66	-0.45	-2.59	4.20	**1.630**	1.300	3.360	59.00	53.00	250.00
Triple-B-rated (Baa)	907.79	-0.39	-1.49	5.84	**2.140**	2.010	5.350	114.00	114.00	457.00
High Yield Bonds ICE Data Services										
High Yield Constrained*	502.18	-0.02	1.37	6.33	**3.983**	3.965	11.400	350.00	350.00	1087.00
Triple-C-rated (CCC)	473.36	-0.05	3.62	6.81	**7.054**	6.997	19.071	674.00	673.00	1862.00
High Yield 100	3360.84	-0.03	0.93	4.15	**3.279**	3.279	10.740	288.00	288.00	1018.00
Europe High Yield Constrained	342.32	0.00	1.37	2.97	**2.600**	2.464	8.183	320.00	300.00	866.00
Global High Yield Constrained	452.65	-0.01	1.17	5.90	**4.070**	4.057	11.310	380.00	367.00	1094.00

Source: https://www.wsj.com/market-data/bonds/governmentbonds

b. <u>P/E of Global Stocks:</u> Price-to-earnings ratio indicates how bullish investors are. We see prices rising while the earnings do not necessarily rise at the same rate. The missing piece in this puzzle is "growth" as companies look to expand and grow their market share and customer base. Figure 3 below shows that the trailing P/E ratio of the global equity market is **27.03** as of *December 31, 2020*. The current multiple is considerably higher than the 30-year average price-to-earnings ratio, which might indicate that the global equities are currently overpriced.

Figure 3: Global P/E Ratio

Global Stock Market: Price-to-Earnings Ratio (TTM)

Date	Global Equity Markets P/E (TTM)	MSCI World (Developed) Index P/E Ratio (TTM)	MSCI Emerging Markets P/E Ratio (TTM)
12/31/2020	27.03	28.86	21.26
6/30/2020	19.63	20.61	16.04
12/31/2019	18.99	20.25	15.02
6/30/2019	17.21	18.43	13.26
12/31/2018	15.12	16.09	12.00
6/30/2018	17.95	19.26	13.61

(Source: https://siblisresearch.com/data/global-markets-pe/)

c. <u>Stock Prices and Index Performances</u>**:** The market is pricing in several factors affecting sky-high valuations. These factors include the recovery from the pandemic, vaccination optimism, central banks supporting recovery through accommodative monetary policies and various governments injecting fiscal stimulus, ease of regulations creating ground for more investment and transactions. Figure 4 below shows the global markets recovering from the deep dive due to COVID-19 last year.

Figure 4: Global Stock Market Indexes

Stock Market Indexes

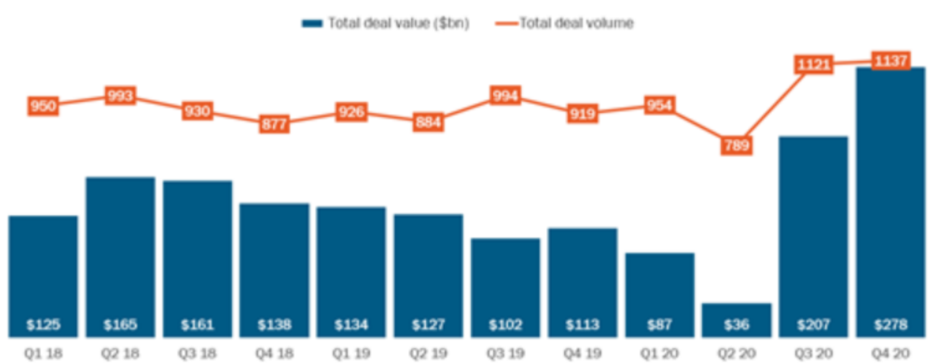
	Date	Level	Ch.	This Week ch.	Mon. ch.	Ann. ch.	YTD
DOW [+]	05/14/2021	34,382.13	1.06%	-1.14%	1.93%	45.53%	12.34%
NASDAQ [+]	05/14/2021	13,429.98	2.32%	-2.34%	-3.09%	50.16%	4.20%
S&P 500 [+]	05/14/2021	4,173.85	1.49%	-1.39%	1.19%	46.32%	11.12%
STOXX 50 [+]	05/14/2021	4,017.44	1.64%	-0.42%	1.04%	45.55%	13.08%
FTSE 100 [+]	05/14/2021	7,043.61	1.15%	-1.21%	1.50%	22.68%	9.03%
DAX [+]	05/14/2021	15,416.64	1.43%	0.11%	1.36%	49.14%	12.38%
CAC 40 [+]	05/14/2021	6,385.14	1.54%	-0.01%	2.84%	49.43%	15.02%
NIKKEI [+]	05/14/2021	28,084.47	2.32%	-4.34%	-5.19%	41.02%	2.33%
TOPIX [+]	05/14/2021	1,883.42	1.86%	-2.57%	-3.52%	30.20%	4.36%
IBEX 35 [+]	05/14/2021	9,145.60	2.00%	0.95%	6.49%	39.72%	13.28%
FTSEMIB [+]	05/14/2021	24,766.09	1.14%	0.63%	0.78%	46.83%	11.39%
PSI20 [+]	05/14/2021	5,195.66	1.62%	0.90%	3.30%	31.25%	6.07%
ASE [+]	05/14/2021	907.08	0.85%	1.12%	0.56%	54.23%	12.12%
ISEQ [+]	05/14/2021	8,101.87	1.29%	-2.82%	0.78%	53.50%	9.84%
MERVAL [+]	05/14/2021	54,850.06	4.23%	6.67%	15.96%	39.83%	7.07%
S&P/ASX 200 [+]	05/14/2021	7,014.20	0.45%	-0.94%	-0.13%	31.63%	6.48%
ATX [+]	05/14/2021	3,422.46	1.82%	2.75%	6.75%	61.74%	23.09%
BSE Bahrain [+]	05/12/2021	1,528.79	-0.07%	-0.07%	4.53%	23.43%	2.62%
BEL20 [+]	05/14/2021	4,066.49	0.85%	0.55%	3.34%	40.25%	12.29%

Source: https://countryeconomy.com/stock-exchange

2. Digital and Technology Innovation

Having discussed asset valuations, let us look at some more themes across the board. The pandemic has reshaped human lives on multiple fronts, including- healthcare, education, shopping, lifestyle, and work. When several sectors like airlines, hospitality, and textiles struggled to remain afloat, the tech companies facilitating our digital lives garnered superior premium to valuations. Technology M&A declined in H1 2020 due to COVID-19 but increased in H2 2020. Figure 5 below shows a V-shaped recovery in technology transactions on account of pent-up demand from both strategic and financial buyers. This trend of Tech M&A is expected to continue in 2021.

Figure 5: Quarterly Global Tech & Telecom M&A



Source: https://www.spglobal.com/marketintelligence/en/news-insights/research/2021-tech-ma-outlook-introduction

It is expected that sponsor-led transactions will continue as global PE firms sit on large dry powder. North American PE firms are estimated to have reserves of close to $1 Trillion that are waiting to be deployed in "quality assets".[3] Notable recent deals are Avedon Capital's acquisition of Netzkern and Macaw, which created a new significant technology services group and the largest Sitecore player in Europe.[4] Furthermore, technology and data analytics is driving companies to ramp up existing capabilities to flourish in the post-COVID-19 era. Some notable transactions include Nvidia's purchase of Mellanox Technologies (Arm) for $6.9 billion, Uber's acquisition of Postmates worth $2.6 billion, and Adobe's acquisition of Workfront for $1.5 billion.[5] [6] We will also continue to see SPAC-led technology acquisition as industry veterans join hands to float

[3] https://www.preqin.com/insights/research/blogs/what-private-equitys-record-dry-powder-haul-means-for-the-industry

[4] https://www.ciesco.com/ciesco-global-m-a-update-q1-2021/

[5] https://www.visualcapitalist.com/visualizing-biggest-tech-mergers-and-acquisitions-of-2020/

[6] https://www.forbes.com/sites/ilkerkoksal/2020/11/10/adobe-acquires-workfront-for-15-billion/?sh=2ae59f19396e

blank cheque companies.[7] Finally, we will continue to witness the surge in data center deals and semiconductor space as the world prepares itself for 5G network capabilities. Notable deals include the Digital Realty acquisition of Interxion ($8.4 billion).[8]

3. ESG theme

The ESG (Environmental, Social and Corporate Governance) theme is now at the world's center stage, like never before. Sustainability-focused investing is not just an exotic term anymore but a reality for investors and companies, who now want to stay clear of unethical practices, polluting assets and companies with the non-compassionate and indifferent supply chain.

The immediate effect on M&A is, of course, seen in the due diligence of existing transactions where we devote good hours in understanding whether the company has been responsible in the past and has great plans for improvement in the future. The reputational risk is just too high for the acquirer/investor if misconducts are unearthed much later in the process, leading to detailed scrutiny and checks upfront.

Investor presentations, pitches, and analyst day messages now emphasize the carbon neutrality targets, best practices, awards, or recognitions won for sustainable initiatives, pioneering innovation in carbon footprint. ESG will become more vital as a factor in screening targets, providing financing arrangements, and building long-term relationships.

4. Divestitures

The pandemic has affected businesses worldwide across industries, sectors, and regions, and quite unequivocally so. As companies rethink their business models and prioritize core segments over others, they sell non-core assets and business segments to strategic buyers. Figure 6 conveys this increased level of disinvestment in the US in 2021.

This data can be further extrapolated to predict increased asset sales in the coming quarters of 2021. As the travel & leisure, media & entertainment industries await normalcy and as the fiscal help dries out, we can expect M&A

[7] https://www.channele2e.com/investors/technology-spacs-list/

[8] https://investor.digitalrealty.com/news-and-events/news/press-release-details/2019/Digital-Realty-To-Combine-With-Interxion/default.aspx

or sale transactions as companies combine to repay mounting debts, improve capital efficiency and remain competitive in the industry. It is noteworthy that several industrial & natural resource companies have also followed the route for similar reasons. For example, **General Electric** sold its **GE Capital Aviation Services** to Dublin-based **AerCap** (Top Cross-Border transaction of Q1 2021). [9] As another example, AT&T's WarnerMedia and Discovery Inc. announced a merger, valued close to $100 billion, structured as a Reverse Morris Trust transaction.[10]

Figure 6: US Corporate Divestitures

Source: https://www.forbes.com/sites/mergermarket/2021/04/19/as-covid-19-stimulus-wanes-distressed-ma-deals-loom/?sh=38bc4dad52bc

Next, we take a deep dive into the key markets and look at regional M&A trends

USA

M&A activity in the USA is only expected to grow on the back of fiscal stimulus and vaccination drive. On March 11, US President Biden signed the $1.9 trillion stimulus package taking the total of the American Rescue Plan Act to about $5 trillion.[11] [12] More than 58% of adults in the US have received at least one dose of vaccine,

[9] https://www.forbes.com/sites/mergermarket/2021/04/19/as-covid-19-stimulus-wanes-distressed-ma-deals-loom/?sh=38bc4dad52bc

[10] https://www.bloombergquint.com/business/at-t-to-merge-media-assets-with-discovery-in-43-billion-deal

[11] https://www.theguardian.com/us-news/2021/mar/11/joe-biden-covid-relief-bill-sign-primetime-address

[12] https://www.crfb.org/blogs/american-rescue-plan-could-set-stage-4-trillion-debt , https://www.spglobal.com/ratings/en/research/articles/210324-economic-research-for-the-u-s-let-the-good-times-roll-11887507#:~:text=Our%20forecasts%20of%20real%20GDP,the%20highest%20reading%20since%201984.

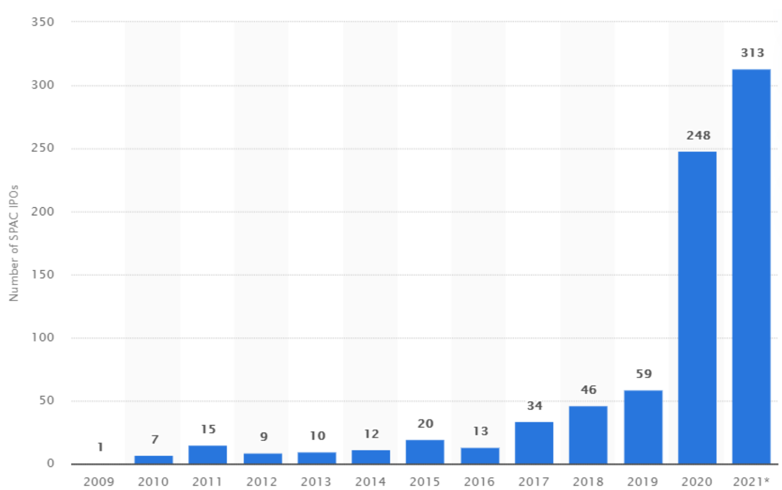
reducing the spread of the virus significantly.[13] The economy is expected to see real GDP growth of 6.5%, perhaps the strongest in the last 40 years.[14]

As mentioned earlier, technology, media & telecom will continue to rule the sectoral pie charts in terms of M&A volume and value. Financial sponsor-led rigorous M&A activity amidst strong fundraising and the need for deployment will keep the M&A chart trending upwards.

The poster boy of US M&A markets lately, SPACs (Special Purpose Acquisition Company) warrant some more attention here. SPACs facilitate early market access, higher capital raise, better business model communication, and growth story-backed investments. They generally target technology & healthcare sectors where the growth lies in a post-COVID-19 world.

As witnessed in Figure 7 below, the year 2020 was supposed to be a record year for SPAC activity, until 2021 beat the charts in just 3 months (January - March). What this chart doesn't tell is the story of April & May 2021 which saw a 90% fall in activity levels, as SPAC activity declined on account of SEC regulations relating to the accounting of warrants issued by these blank cheque companies.[15] In the remaining quarters of 2021, we expect SPAC activity to taper down further.

Figure 7: Number of SPAC IPOs in the US (2009-April 2021)



Source: https://www.statista.com/statistics/1178249/spac-ipo-usa/

Strategic cross-border M&A continues to be the preferred international expansion route as companies search for pockets of growth globally. North American firms swoop in to buy European assets & firms, as the travel

[13] https://www.usnews.com/news/national-news/articles/2021-05-11/cdc-35-of-americans-fully-vaccinated-against-coronavirus

[14] https://www.businesstoday.in/current/world/us-fed-forecasts-strongest-economic-growth-in-40-years-despite-inflation-jump-in-2021/story/434179.html

[15] https://observer.com/2021/04/spac-deal-ipo-slowdown-april-sec-crackdown/

restrictions are easing across the world.[16] Companies acquire capabilities to automate operations and enhance efficiency (rather than developing "greenfield" operations). Europe is showing signs of an economic rebound, thus providing several growth opportunities. Notable deals are: US-based Jazz Pharmaceuticals acquires UK-based GW Pharmaceuticals for $7.2billion.[17] US SPAC AJAX acquires UK-based Cazoo in a $7 billion combination.[18] We expect the Cross-Border trend, both inbound and outbound transactions to continue in 2021.

Europe

As borders opened this year gradually, the pent-up M&A activity brought good news to an otherwise flat European transactions trend of 2019-2020. European M&A volumes are up 34% year-on-year in May 2021, driven mainly by UK & France. [19] [20] UK inbound M&A remains robust as global companies look to enhance capabilities. Growth M&A rose on the back of vaccine rollout, even as companies remained cautious of Brexit's geopolitical impact. UK volumes would continue to show an uptick in 2021.[21] For France, the $16 billion Suez-Veolia (hostile) takeover constitutes close to 50% of M&A value.[22] The two largest wastewater companies joined hands to compete with rising Chinese players emerging in the industry. Some European M&A trends include:

- Creation of pan-European champions: As firms navigate the labyrinth of global geopolitical tension, they move towards near-shoring. They are moving back their supply chains to nearby countries to make it shockproof amidst uncertainty.
- Consolidation to create larger, competitive entities: Just like the Suez merger discussed above, the Caxia and Bankia merger would create the largest bank in Spain to improve profitability & efficiency.[23]
- Hostile Takeovers to continue in 2021: While Intesa's aggressive takeover of UBI is feared to create a monopoly, it does go on to cement the Hostile M&A trend in Europe.[24] [25]

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[16] https://www.ey.com/en_in/ccb/mergers-acquisitions-strategy-survey-summary

[17] https://investor.jazzpharma.com/news-releases/news-release-details/jazz-pharmaceuticals-acquire-gw-pharmaceuticals-plc-creating

[18] https://www.businesswire.com/news/home/20210328005028/en/Cazoo-to-Become-Listed-on-NYSE-through-7.0-Billion-Business-Combination-with-AJAX-I

[19] https://www.mergermarket.com/info/global-dealmakers-cross-border-ma-2021

[20] https://www.acuris.com/1q21-global-ma-report-financial-league-tables

[21] https://www.iflr.com/article/b1qxjv9n6rr5fl/mampa-report-2021-united-kingdom

[22] https://www.environmentalleader.com/2021/04/veolia-suez-strike-merger-deal/

[23] https://www.cnbc.com/2020/09/18/caixabank-and-bankia-to-merge-creating-spains-largest-bank.html

[24] https://www.reuters.com/article/us-ubi-m-a-intesa-sanpaolo-idUKKCN24T0PI

[25] https://www.ft.com/content/4788c0b2-96a1-4c25-bcdd-ac6fb6595219

The strategic M&A momentum is expected to continue. SPACs looking for target companies & PE-led investing will boost overall activity.

MENA (the Middle East & North Africa region)

The Middle East & North Africa continue to see a meteoric rise in M&A with volumes being 5x & 12x YoY (May 2021) respectively, as companies focus on streamlining costs, boosting efficiency, and optimizing operations. Factors leading to transformational activity in the region are:

- Cash-rich Sovereign Wealth Funds driving M&A activity in the region. Lower interest rates, idle capital, and weak equity markets due to COVID-19 led to huge investments. Saudi Arabia's Public Investment Fund buying stakes in Boeing, Facebook, Walt Disney, Jio Platforms is an example of PE-led M&A volume rise. [26]
- Battling the twin shock of COVID-19 & lower oil prices, companies consolidated to survive. Saudi Arabia's largest bank NCB combined with Samba Financial Group for $15.4 billion.[27]
- Several other factors, including supply chain disruptions, resulted in an increase in domestic activity, public sector consolidation and privatization.
- Egypt becomes a destination of choice for investment inflows.[28] Continued economic growth, legal reforms easing foreign investment, the discovery of vast offshore gas reserves lead to a rise in M&A volumes.[29]

The year 2021 would continue to witness portfolio rejigs, divestments & outbound PE investments leading to heightened M&A in the region.

Asia Pacific (APAC)

Chinese M&A activity accounts for half of the APAC's about $360 billion transaction value for YTD May 2021, led by technology deals.[30] As regulators crack down on technology giants, such as Alibaba, Tencent, and JD.com, to curtail their political & media influence in the country, companies divest their sensitive overseas assets.[31] Impending divestment in non-core businesses by these online titans would continue to raise M&A charts in 2021.

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[26] https://www.arabnews.com/node/1783476/business-economy
[27] https://www.arabnews.com/node/1747926
[28] https://www.zawya.com/mena/en/wealth/story/Under_the_spotlight_Egypts_prominent_MA_deals-SNG_185736709/
[29] https://www.arabnews.com/node/1788431/business-economy
[30] https://www.acuris.com/1q21-global-ma-report-financial-league-tables
[31] https://theprint.in/world/china-crackdown-on-jack-mas-alibaba-drives-200-billion-tech-selloff/575457/

PE buyout on the back of China's economic recovery and growth prospects is expected to flow into the transport & logistics sector as SOE (State Owned Enterprise) reforms and e-commerce boom multiply the demand for private investment.[32] State-led consolidation was evident in Xinjiang Tianshan's acquisition of four regional peers for $15 billion, as the government looks to bring in structural reforms on the supply side.[33] China's M&A market would be an exciting space to watch in 2021 as activity levels become rigorous.

Indian M&A has been on a strong footing up until Q1 2021 with RMG's acquisition of Renew Power for $8 billion, being the largest inbound deal.[34] Continued investments from PE funds in pharma & technology companies drive the deal volume as the country remains an attractive market on account of its young population. Sino-US trade war puts Indian economy in a sweet spot as investors look to safeguard their returns. However, the 2021 outlook for India is marred by the intense COVID-19 second wave and deal volume is expected to plummet in coming quarters.

Concluding note

The year 2020 is often called the year of two halves. The first half saw nations fighting the virus, which shook the global economy, markets and M&A levels nose-dived. [35] The second half saw a remarkable recovery in the deal-making space as companies rushed to gather ammunition for survival and expansion. We expect a recovery in deal activity in 2021 due to vaccination & fiscal stimulus-led optimism. How PE funds deploy the accumulated capital in pockets of growth worldwide would be an exciting story to watch out for. It also remains to be seen how companies move to the tune of pandemic-induced global trends and state-led regional reforms.

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[32] https://www.weforum.org/agenda/2020/05/how-reform-has-made-chinas-state-owned-enterprises-stronger/

[33] https://www.ft.com/content/e4d0516e-cddc-44e7-8ea6-ea66c7e78b15

[34] https://renewpower.in/wp-content/uploads/2021/02/RMG-II-ReNew-Power-Transaction-Announcement-Press-Release-Feb-2021.pdf

[35] https://www.ft.com/content/1caa7059-2e4e-4b9e-b365-8944478509a4