

M&A Insights

Q4 2020

Towards a new era







Contents

M&A market shows signs of recovery in second half	04
Global M&A snapshot	06
Biden election set to boost investor confidence	08
Financial services: towards digitalisation and consolidation	10
Connecting data centres: attracting investors	11
Global deal flows	14
Healthcare accent is on smaller deals	15
U.S. and China relations will take time to mend	16
UK national security regime: scrutiny of transactions tightens	18

M&A market shows signs of recovery in second half

2020 has been a year of two very distinct halves but signs of recovery give grounds for optimism.

Deal activity across regions and sectors came to a near standstill in H1 as the pandemic spread rapidly around the globe.

The effect of that has been to depress both deal value and volume for the year as a whole, down by 8% and 9% respectively.

Strong recovery in deal activity

But those figures obscure an extraordinarily strong recovery in deal activity that began in the late summer and has continued through the rest of the year, with private equity funds playing a particularly active role in the turnaround.

Against that background we are seeing something of a recovery in the value of cross-border transactions, which have been under pressure for some time. However deal volume for the year remains depressed.

Despite the uncertainties caused by Covid-19 and a highly divisive presidential election, the U.S. remains the most active outbound investor and the leading target nation for inbound investment.

In some sectors we are seeing investors do a larger number of smaller transactions.

Megadeals have therefore declined, having underpinned overall market growth in recent years.

- The value of deals over USD5 billion has declined by 8%.
- The value of deals in excess of USD10bn have fallen by 21%.

Will the market recovery last?

The big question is: can the recovery in deals be sustained?

There seems good reason to believe it can. Global stock markets have soared, both on the election of Joe Biden and on news that three potential vaccines have proven highly effective in late trials.

Markets seem to welcome the return of a more predictable kind of politics and the fact that a Democratic President will probably be held in check by a Republican Senate.

But there are reasons to be cautious as well.

The pandemic is far from under control and the scope for severe long-term economic shocks in its wake remain very real. Market conditions could stay pretty choppy in 2021 as a result and investors' nerves will continue to be tested in the months ahead.



8%

Decrease in global deal value
Q4 2020 vs. Q4 2019



9%

Decrease in global deal volume
Q4 2020 vs. Q4 2019

Note: Figures represent deals announced between 1 January 2020 and 7 December 2020.

Data provided by

REFINITIV


For more information, please contact:



David Broadley
Global Co-Head, Corporate/M&A
Tel +44 20 3088 3258
david.broadley@allenovery.com

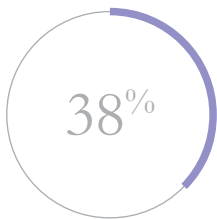


Dirk Meeus
Global Co-Head, Corporate/M&A
Tel +32 2780 2432
dirk.meeus@allenovery.com

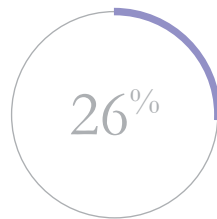


Global M&A snapshot

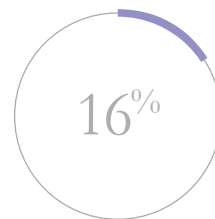
Split of global M&A deals by value



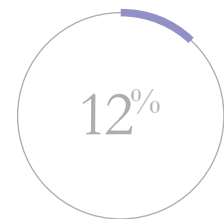
U.S.
Deal value: USD1.2tn



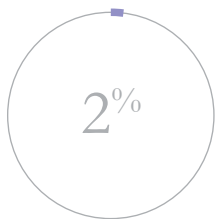
Western Europe
Deal value: USD822bn



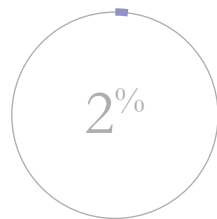
Greater China
Deal value: USD523bn



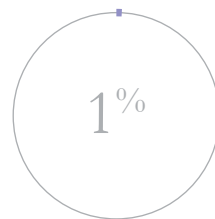
APAC (excl. China)
Deal value: USD392bn



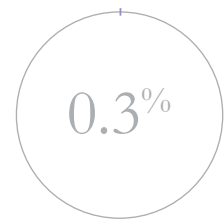
CEE and CIS
Deal value: USD65bn



MENA
Deal value: USD61bn



Latin America
Deal value: USD41bn



Sub-Saharan Africa
Deal value: USD10bn

% change from Q4 2019

▼
27%

U.S.

▲
28%

Western Europe

▲
39%

Greater China

▼
3.4%

APAC (excl. China)

▲
51%

CEE and CIS

▼
53%

MENA

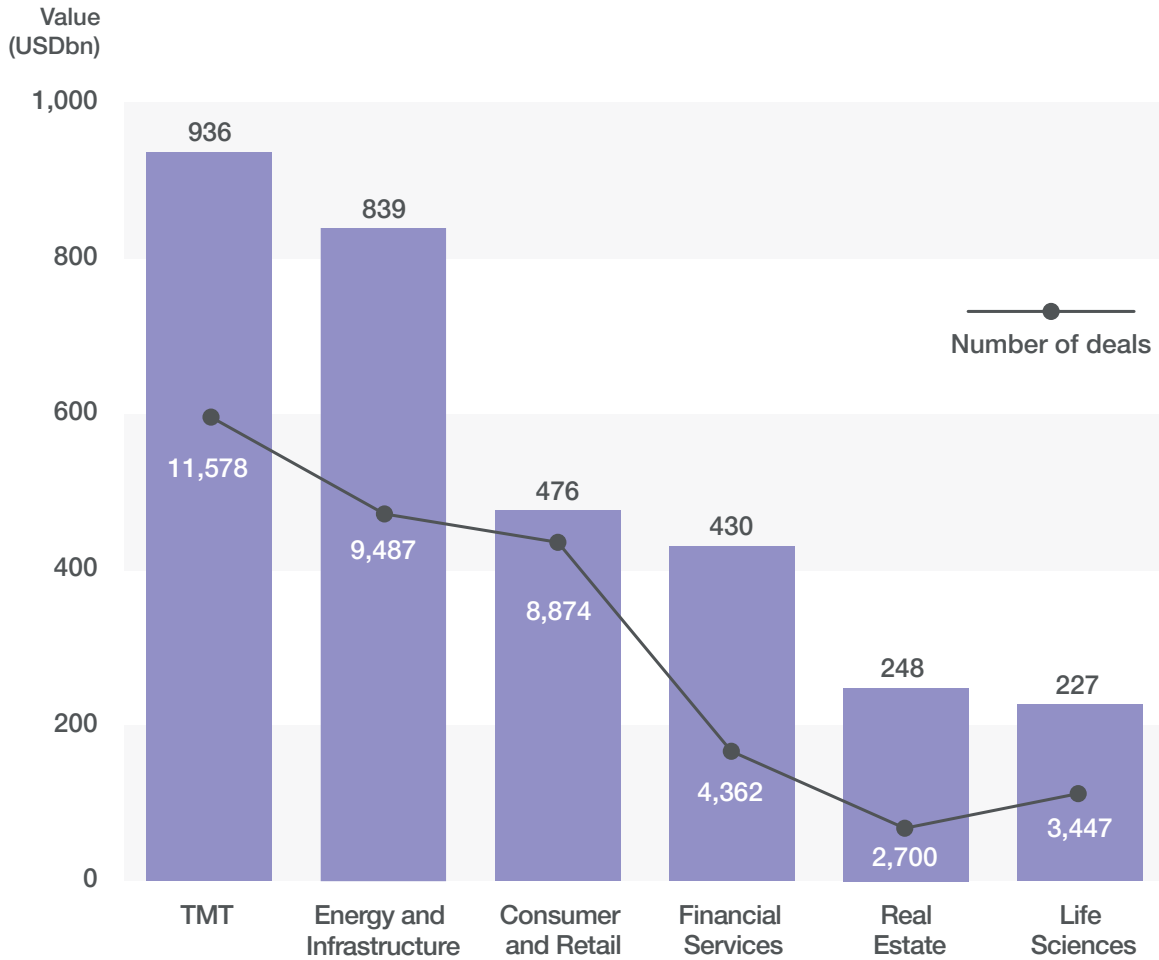
▼
56%

Latin America

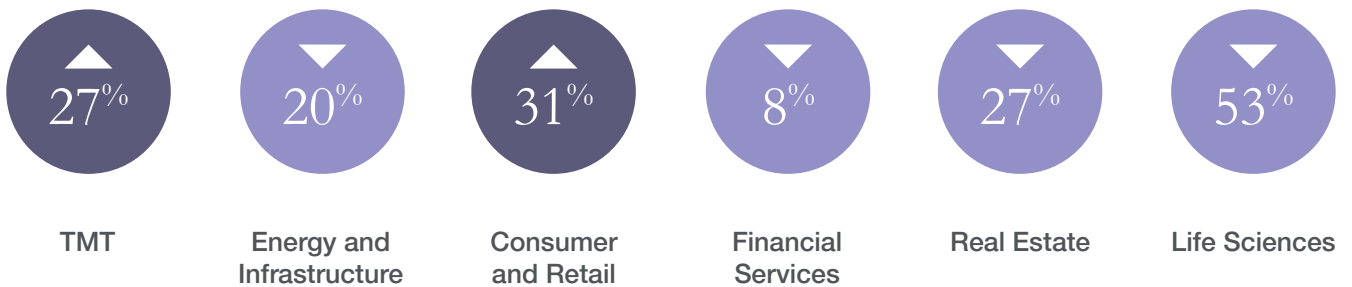
▼
48%

Sub-Saharan Africa

Global M&A by sector, Q4 2020



Deal value % change from Q4 2019



Biden election set to boost investor confidence

The election of Joe Biden is likely to usher in an era of more stable and predictable politics in the U.S., increasing the kind of investor confidence on which M&A transactions thrive.

As such, we expect the strong growth in activity that we have witnessed over recent months to continue once the transition to a new administration is finally complete.



27%

Decrease in U.S. deal value
Q4 2020 vs. Q4 2019



2%

Decrease in U.S. deal volume
Q4 2020 vs. Q4 2019

New policy directions

In terms of likely policy outcomes, much will depend on the make-up of Congress. Control of the Senate will not be decided until January.

Traditionally the U.S. market prefers to see government divided between the administration and Congress (in this case, a Democratic administration and a Republican Senate) but will probably adapt easily whatever the outcome turns out to be, given that this looks set to be finely balanced in any event.

However, we can expect a change of direction in key policy areas, including:

- greater antitrust enforcement, particularly for consumer-facing industries
- action forcing the big internet companies to change their business models, although falling far short of break up
- possible tougher regulation on the big banks
- extension of the Affordable Care Act (Obamacare) could increase pricing pressure on the healthcare sector

Some of these measures could put a damper on M&A activity, but largely the effect should be relatively mild.

The drivers of M&A activity will remain largely unchanged. Drivers include:

- the search for ways to accelerate growth
- pressure to consolidate within sectors to improve efficiency and costs
- the need to deploy pent up reserves of liquidity
- continuing access to affordable debt finance for the right deal

Covid-19 is the biggest unknown

But the biggest threat to activity remains Covid-19. Any positives or negatives arising from the election will be overshadowed by whether the pandemic is brought under control and if the economy is forced to withstand lockdowns.



Financial services: towards digitalisation and consolidation

U.S. financial services sector M&A picked up in the second half of 2020, in line with the wider U.S. market. Asset management and fintech investments led the way, with regional bank mergers also showing signs of growth.

Morgan Stanley has been most active, building both its asset and wealth management arms. Following its USD13bn acquisition of E*TRADE, the online stock brokerage, earlier in the year, it also recently announced the acquisition of asset manager Eaton Vance in a near USD7bn deal.

Whether other banks will follow a similar path is yet to be seen. Goldman Sachs indicated that it will look to grow its asset management business organically but does not rule out dealmaking. J. P. Morgan has indicated that it could, in principle, be interested in acquiring an asset manager.

More activity is likely in both asset management and wealth management as achieving scale and cost synergies drives consolidation across both industries.

Independent mid-sized and domestic wealth management companies continue to be aggressive in pursuing growth opportunities through acquisitions, seeking to fend off challenges from the bigger industry players. Economies of scale and the continued rise of index and ETF products are all putting additional pressure on asset managers to consolidate in order to compete.



Fintech deals dominate

Fintech remains a sector with significant opportunities. M&A, consortium deals and minority investments have continued despite the Covid-19 disruption.

Banks are searching the globe to find transformative digital technologies and are not alone in their interest in this area – venture capitalist (VC) and corporate investors are equally focused on fintech.

Large corporates have been active in the space:

- Visa Inc acquired Plaid Inc for USD4.9bn.
- Mastercard announced its acquisition of open banking company Fincity.
- U.S. payments companies have been receiving particular interest, with Stripe, Chime, Nubank, Bakkt and Varo raising significant funds. In addition, challenger banks Revolut and N26 joined the fray, entering the U.S. market.

Fintech is one to watch, especially in the coming months as the economy recovers, confidence builds and the market continues to diversify.



Bank consolidation

While the largest U.S. banks have been unable or unwilling to engage in M&A activity in the banking sector, there is evidence of renewed life for domestic banking mergers:

- PNC's recently announced USD11bn acquisition of BBVA's U.S. banking arm
- First Citizen's USD2.2bn acquisition of CIT

The need for growth to compete with the larger banks and the pressure to search for profitable business in a low interest rate environment will continue to drive consolidation among the mid-sized regional banks in the U.S.



Election effect on M&A market

The election of Joe Biden is unlikely to have a significant impact on U.S. financial services M&A in the short term. With control of the Senate likely to stay in Republican hands, legislation that could impact transactions in the sector is unlikely to be passed.

While tougher regulation or enforcement in the financial sectors could dampen activity, especially for larger institutions, the implications of increased regulatory activity would not be immediate and would not change many of the key M&A drivers. The need for continued consolidation among mid-sized banks, asset managers and wealth managers, as well as the growing influence of technology on the financial sector, will remain.

Connecting data centres: attracting investors

With the explosive growth in connected working and living, data centres are attracting an increasingly wide range of investors and activity looks set to grow.

There are few parts of the global M&A market that have weathered the pandemic quite so powerfully as the data centre sector.

Deal activity has continued to grow despite the tough trading conditions caused by the Covid-19 coronavirus.

The first quarter of 2020 saw 15 data centre deals close, with a value of some USD15bn, exceeding levels seen in the whole of 2019, according to Synergy Research Group.

Indeed, with transactions continuing throughout lockdown and with further deals in the pipeline, it is predicted that 2020 deal values could exceed the previous peak year of 2017.

It's not surprising given the speed at which people have moved to remote working and adopted online services in the long months of lockdown.

Add to that the explosive growth of cloud computing in recent years, the advent of 5G mobile technology, advances in AI and increasing deployment of Internet of Things devices, and it's easy to see why investment in this area is rocketing and attracting an increasingly diverse range of investors.



Major tech companies lead data centre boom

The data centre boom has been led by the giant tech companies, including Google, Amazon, Facebook, Microsoft, Alibaba and Tencent. Their need for data processing on a massive scale has seen them build campuses across the globe, usually self-financed.

We are seeing continued growth amongst these so-called “hyperscale” operators. For instance, Google, which already operates seven campuses outside the U.S., including five in Europe, was reported to have bought a 33-acre parcel of land north of London in October, thought to be a potential site for its first UK data centre.

A raft of independent “neutral host” data centre operators (known also as collocation operators) has emerged in recent years, building, managing and operating centres on behalf of clients across the globe.

Again, they continue to be very active in both acquiring assets on their own behalf and seeking investment from a range of sources to progress expansion plans.

Deals this year include:

- Digital Reality’s USD8.4bn acquisition of Interxion, the biggest data centre transaction on record
- Equinix’s acquisition of 13 Canadian data centres for USD780 million in October from BCE Inc

We are also seeing alternative investment funds looking at data centres and other parts of data network infrastructure as a long-term investment opportunity.

Here PE funds have been particularly active, dominating data centre transactions in 2019 and continuing to invest heavily this year.

Recent developments include:

- KKR announcing plans for a USD1bn investment in European data centres through a newly created platform, Global Technical Reality
- EQT’s acquisition of EdgeConnex

Now the range of funds circling this market is growing, with real estate investors and dedicated infrastructure funds joined by pension and sovereign wealth funds in looking for investment opportunities.

Core asset re-evaluation

Funds’ interest in the market follows a period of re-evaluation of what constitute core and core-plus infrastructure assets.

Traditionally core assets constituted water and power networks delivering predictable, long-term index-linked returns. Now new kinds of assets that replicate these reliable returns are being added to the core category.

Increasingly the view is that data centres and associate network infrastructures, although not monopolistic in nature, do share some of the qualities of utility businesses. The pandemic has provided proof that these digital assets have not only become an indispensable part of modern life but are also resilient to the types of disruption caused by Covid-19.

It remains relatively early days for some funds. These are often complex deals requiring multi-disciplinary skills across real estate, infrastructure, technology, data and finance. Not all funds have worked out where data infrastructure fits into their broader portfolios.

As such, it is too early to say if we will see a wall of money deployed in this market in the next five to ten years, but that certainly seems to be the direction of travel.

Deal varieties

We are seeing a range of deals in the market.

They include:

- continued greenfield developments by the hyperscale players
- further expansion by co-location operators, often seeking investment from funds to finance their growth and increasingly targeting hyperscale clients
- investment in existing, but under-utilised, centres where the owner is looking to monetise spare capacity by bringing in new partners

Platform deals are also becoming more common in line with a trend we are also seeing in the renewable energy sector.

Here, funds are looking to gain entry into the market by buying a group of data centre campuses within a region, often keeping the current management on board to operate the business.

For example, in April Macquarie Infrastructure and Real Assets acquired an 88% stake in AirTrunk to develop and expand its network of data centres across Asia.

Sustainability factors

Data centres are notoriously energy hungry. They are estimated to have accounted for some 1% of global electricity usage in 2018.

Although data centre design is becoming more energy efficient, the risk of tougher environmental regulation remains real as efforts to tackle climate change become more urgent.

Infrastructure funds are under sometimes competing pressure from their investment committees. They are urged to deploy capital at scale, but are also expected to take account of sustainability or environmental, social and governance issues as they do so. This is likely to be a factor when considering whether this is a market they do indeed want to invest in.

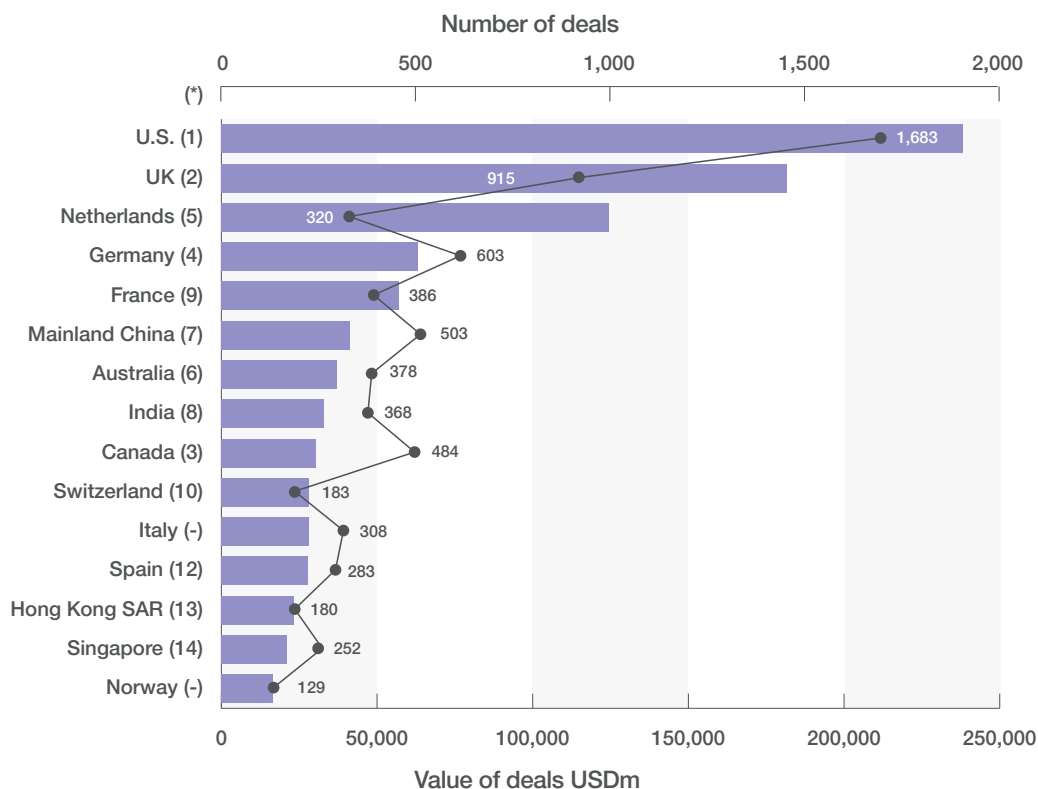
All the signs to date show that a growing number of funds believe the investment opportunities in this area far outweigh the risks.



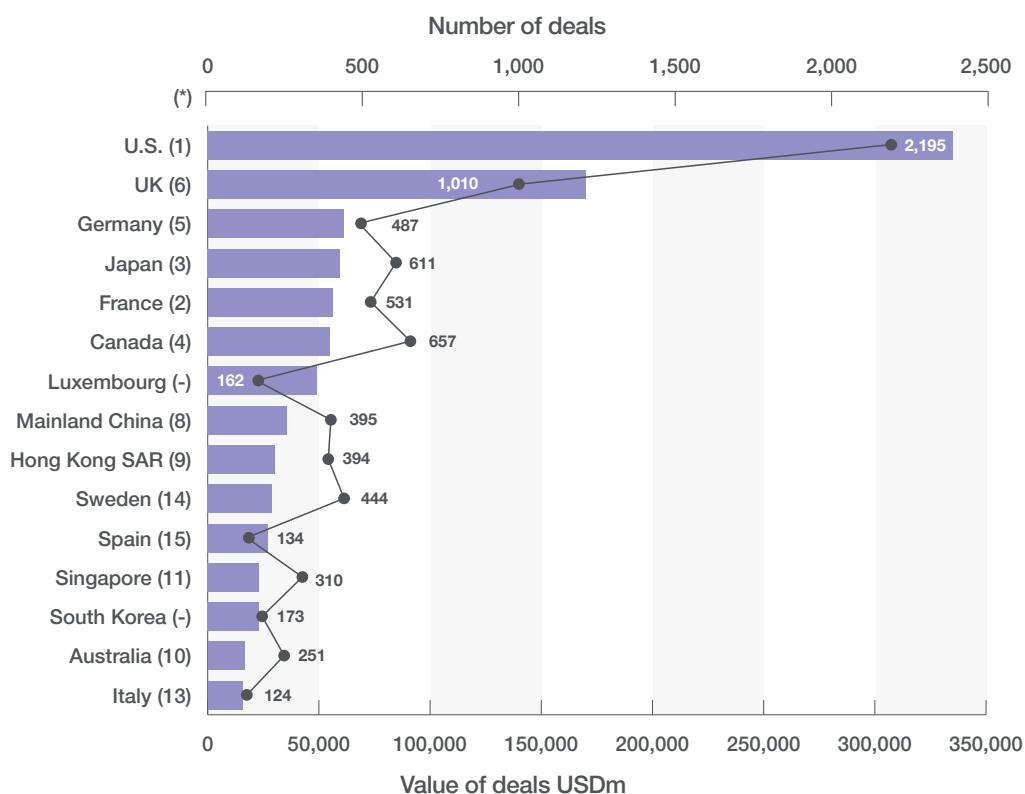
Global deal flows

● Value of deals USDm
 ● Number of deals
 *(Position by deal value in Q4 2019)

Inbound target markets, Q4 2020



Outbound acquirer nations, Q4 2020



Healthcare accent is on smaller deals

Transactions in the U.S. healthcare space rebounded in autumn, although with a greater proportion of smaller deals than in recent years.

In the year to date, deal value has fallen sharply, but volume has decreased only marginally.

Megadeals, common in the sector two or three years ago, are less frequent now.

However, we did see some sizeable deals in Q3, including cross-border transactions, following the plummet in activity when Covid-19 first gripped.

These included:

- Gilead’s USD21bn acquisition of Immunomedics
- Siemens Healthineers’ purchase of Varian for USD16.4bn
- Bristol-Myers Squibb’s USD13bn MyoKardia takeover
- Sanofi’s USD3.4bn purchase of Principia Biopharma

The prevailing trends are smaller bolt-on acquisitions and a growth in consortium deals (where partners pool IP and R&D to spread costs, striking licensing and revenue share agreements once products go to market).

Here certain areas are ripe for transactions, particularly digital medicine, pharma companies digitising operations, IT businesses anxious to enter the healthcare space, genetics, viral treatments and vaccines.

Affordable care

It remains to be seen how far a Biden administration can push its plans to extend the Affordable Care Act (Obamacare). Much will depend on whether Republicans hold sway in the new Senate.

Although there may be pricing pressure on the sector, we do not expect this to be an overly significant burden on pharma companies, insurers or health care providers – at least in the nearer term. By and large they have benefited from healthcare reforms.

The Covid-19 crisis has forced a wide range of companies to divert resources towards developing a vaccine, perhaps at the expense of funding other R&D programmes. Getting these back on track could actually act as a stimulus to collaborative deals.

Cross-border investment

As trade tensions between the U.S. and China gradually ease, we expect to see more interest from Chinese companies in the U.S. healthcare sector.

With the exception of some biotech deals, investments in this area have escaped deep scrutiny by the Committee on Foreign Investment in the U.S. (CFIUS).

With the U.S. likely to take a more multilateral approach to international affairs, once the presidential transition is complete, we could see well-financed Chinese inbound investors returning to the U.S. market for the first time in many months.

“With the U.S. likely to take a more multilateral approach, we could see well-financed Chinese inbound investors returning to the U.S. market for the first time in many months.”

U.S. and China relations will take time to mend

The arrival of Joe Biden in the White House will give the U.S. and China a chance to put their political and trade relations on a new footing.

But the complexities of the current relationship mean that it might take longer than one presidential term to achieve some kind of *détente*, if indeed that is possible.

Relations have soured dramatically during the Trump era.

But it is important to remember that some of the issues at stake, such as IP, technology and the desire to protect sensitive personal data, pre-date President Trump's tenure and it was always inevitable that they would rise to the surface at some point. They are now in full bloom.

Retaliatory trade wars

As the trade war between the two countries has intensified, we have seen both sides clash on a range of issues, such as:

- capital market controls
- currency
- export controls and sanctions
- technology
- national security

China, still intending to continue opening its economy, has matched the U.S. in implementing measures allowing it to retaliate. Recently, in the wake of the forced sale of TikTok, it set up its own sanctions regime and introduced tech export controls.

The new U.S. administration is expected to pursue, at least in terms of engagement and communication, a more conventional diplomatic approach.

Nevertheless, Biden still has to take account of a sizeable domestic constituency that is hawkish about China and the legacy positions of the Trump administration. The difficult fundamental issues over which the two countries have clashed will need hard negotiations to reach an understanding.

In future it's unlikely, for instance, that CFIUS will be any less scrupulous.

Three possible scenarios

We see three possible ways the relationship could develop in the coming years:

1. antagonistic rivalry escalates, with severe impact on the tech sector and the global economy
2. two countries enter a fragmented engagement, the most likely outcome in the short term
3. cooperation in areas of mutual concern (i.e. climate change)

Conflicts may continue in contentious areas and move into new sectors such as finance. But China's response would likely remain measured to protect foreign investment and pursue its long-term goal of moving from an export-orientated economy to a green, hi-tech and consumer-orientated one.

A Biden focus on developing a team of seasoned veterans to prioritise and concentrate on China will be crucial to setting the tone. From the appointments already announced, this approach seems to be playing out.

Implications for deals

The President-elect's determination to re-join the Paris climate accord and re-engage with the World Health Organisation are two areas where consensus may be found and are hopeful signs of a more multilateral approach.

Meanwhile, we expect Chinese outbound investors to become more active in the U.S., in non-contentious sectors that are likely to withstand CFIUS scrutiny, if a cooperative environment can be created.

China will also seek to continue attracting inbound investors as its economy transforms.

Companies operating in different markets could be caught between the two giants, as we saw with the Huawei/5G scenario.

For those operating in Asia, securing supply chains is key. Singapore offers a centre to target Southeast Asian markets, and Hong Kong SAR acts as a gateway to Mainland China.

Notwithstanding the potential for continued flare-ups, we expect a modest easing of U.S.-China tensions to create a more receptive deal environment in the short to medium term.

Worst case

Antagonistic rivalry

- accelerated decoupling and bifurcation
- equivalent retaliation
- multi-polar tension

Medium case

Fragmented engagement

- sustained tension over technology, IP and other sensitive areas
- cooperation over areas of mutual interest
- no comprehensive framework of cooperation

Best case

Partial agreement and accommodation

- active cooperation on shared global issues
- compromise reached over difficult issues (technology and trade)

UK national security regime: scrutiny of transactions tightens

The UK government has finally delivered on its promise to tighten the scrutiny of transactions on national security grounds.

Laying out its proposals on 11 November in the new National Security and Investment Bill, the UK government stressed it does not want to discourage foreign investment.

The new regime, applicable to domestic and foreign investors alike, is intended to catch only transactions raising

national security concerns, and aims to ensure that the UK remains an “attractive place to invest”. With these proposals, the UK joins a growing band of countries that are strengthening or introducing national security screening regimes, including the U.S., Australia, France and Germany.

But the potentially far-reaching measures will certainly add a new level of administrative burden and potentially also transaction risk to M&A activity in the UK.

Mandatory notification

Under the proposed legislation it will be mandatory to notify any qualifying transaction in 17 so-called “sensitive” sectors:

Civil nuclear power	Communications	Defence
Data infrastructure	Energy	Transport
Artificial intelligence	Autonomous robotics	Computing hardware
Cryptographic authentication	Advanced materials	Quantum technologies
Engineering biology	Military or dual use systems	Satellite and space technologies
Critical suppliers to the government	Suppliers to the emergency services	

Acquisitions that involve the acquirer taking 15% or more of the target’s votes/shares (and subsequent specified step increases), or gaining the ability to influence resolutions governing the target’s affairs, will be caught by the mandatory regime.

“Call-in” powers

The Bill also introduces both a “call-in” power and a voluntary notification system for an extremely wide range of transactions that qualify as trigger events across all sectors of the economy. Minority acquisitions, asset purchases, IP licences, loans and conditional deals are among the transactions that could be caught.

Voluntary notification of deals that potentially raise national security concerns will be through an online portal to a new Investment Security Unit, set up in the Department for Business, Energy and Industrial Strategy.

The government will have the power to call-in any qualifying transaction completed on or after 12 November 2020 for up to five years, or within six months of the government becoming aware of it.

This retrospective power will not be exercisable until the Bill becomes law, probably early in 2021, but is not anticipated to affect a large number of transactions.

There are no turnover or market share thresholds attached to either the mandatory scheme or the call-in powers. The target only needs to operate or supply customers in the UK to fall into the net.

Enforcement

As with the current system, the UK government will be able to impose remedies or even halt a transaction completely.

But there will be tough new sanctions for non-compliance, including:

- fines of up to 5% of global turnover or GBP10m, whichever is greater
- up to five years’ imprisonment for individual offenders

Transactions subject to the mandatory notification requirement will be void if they take place without clearance.

National security vetting will be separate from, and may run in parallel with, review under the merger control regime by the Competition and Markets Authority (CMA). But the proposals effectively mean that national security issues can ‘trump’ competition concerns (although the CMA will still be able to review deals on other public interest grounds such as financial stability and media plurality).

The government predicts that the proposed measures will potentially generate over 2,000 “early engagements” with it, resulting in over 1,800 notifications each year, with up to 95 transactions called in for detailed review and ten involving remedy decisions.

It remains to be seen if that is an accurate estimate. The Bill is far more radical than a mere tweak to existing procedures as it establishes an entirely new regime with teeth.

GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,500 people, including some 550 partners, working in over 40 offices worldwide.

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.