Baker Tilly International - Acuris thought leadership campaign

Global dealmakers: North American M&A market update 2020

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Contents

Methodology

From April to May 2020, Baker Tilly International commissioned Acuris Studios, the publishing division of Acuris, to canvas the opinions of 60 dealmakers to gauge their opinions on M&A opportunities, trends and challenges in North America. Respondents were evenly split and based in the following regions: Asia Pacific, North America and Europe.

Within the graphed survey results, percentages may not sum to 100% due to rounding, or when respondents were allowed to choose more than one answer. All quoted data is propriety Mergermarket data unless otherwise stated. All deals are based on announced transactions.

Foreword

A half year marked by a pandemic and fears of recession has shaken dealmaker confidence in the North American market. The remainder of the year may not be much brighter, although M&A will remain a priority for both corporations and private investors.

Since COVID-19 began sweeping the globe in March, we are finally getting some visibility of the pandemic's impact on M&A. Declines in North American dealmaking have been swift, with deal totals in the first half of 2020 sinking to some of the lowest in recent memory. Investor sentiment has sunk with it and most participants in our research say they are putting M&A on hold until the COVID-19 crisis is resolved. While most respondents say they will be decreasing investments into North America in the year ahead, there are holdouts who say they will stay the course or even increase deals, aware that the pandemic is only temporary and hopeful that North America will recover strongly.

Whatever their intentions, dealmakers foresee several trends shaping North American M&A through the rest of 2020 and early next year. Distress-driven deals and depressed valuations will arise as companies and target assets struggle to recover from lost revenues and operational disruptions as a result of COVID-19. To strengthen against recession and future market complexities, these opportunities could see industry leaders adopt consolidation strategies to complete mergers.

However, others say the year ahead will be private equity's time to shine. With record amounts of dry powder at their disposal, respondents agree that buyouts and large moves from private buyers will be a leading trend, creating competition for assets and buttressing M&A to some extent against more significant declines.

This latest issue of our 'Global Dealmakers: Cross-border M&A outlook' series looks at these issues and others likely to impact dealmaking in North America. As with past publications, we returned to the market to ask questions about investment intentions and views on M&A in North America. The feedback from dealmakers has helped paint a vivid picture of the trends and challenges shaping M&A, as well as the drivers and market factors where opportunities are waiting to be discovered.

As with the rest of the world, 2020 will be an icy year for dealmakers in North America. Those with strong balance sheets and plenty of dry powder are likely to remain open to dealmaking as the year progresses and businesses return to normal trading levels. Businesses that have navigated the conditions, successfully pivoted to remain relevant to their clients and performed well in unprecedented trading conditions will prove their worth. It will be these businesses that are likely to be rewarded by buyers.

Michael Sonego, Partner, Pitcher Partners Australia, Global Corporate Finance Lead, Baker Tilly International

Key findings

55%
of dealmakers say they will decrease investments into North America in the year ahead

87%
say the recent spread of COVID-19 is having a negative impact on their investment decisions

50%
say they will not consider cross-border M&A until the pandemic abates

2,287
M&A deals completed in North America in 1H20, a decline of 35% from 1H19

US$286bn
in total M&A deal value in 1H20, a decline of 73% from 1H19

83%
say distress-driven M&A will be the top deal driver in the year ahead

Valuations and private equity buyouts
will also drive dealmaking

48%
say the level of private equity activity will increase over the next 12 months

43%
say exit conditions for private equity firms are not ideal at present

78%
say finding a buyer willing to pay the desired valuations will be the top exit challenge for private equity firms

47%
say the upcoming US elections in November will have a negative impact on M&A, while 30% say it will have no impact at all

42%
say deal opportunities are worse in North America than other global markets; however,t 52% say they are about the same

M&A in North America: **1H20 review and outlook**

COVID-19 and rising fears of recession are dampening M&A, with dealmaking declining in the first half of 2020. Yet even as confidence wanes, some dealmakers still see opportunity in the North American market.

North American M&A may not have ground to a halt amidst the COVID-19 health crisis, however, deal figures posted precipitous drops from 2019. Deals in 1H20 declined 35% by volume and 73% in value (2,287 deals worth US$286bn) from totals in 1H19 (3,520 deals worth US$1tn).

Depressed deal flow could become the trend for the year ahead, with most dealmakers in our research saying that M&A will be put on hold until conditions stabilize and they have greater visibility on the future. More than half (55%) say they will be decreasing investments into North America and only 18% say they will be making moderate increases.

Negative sentiment was strongest toward the US, where 42% say they will be significantly scaling back investments. Most dealmakers cited the US government's slow and somewhat ineffective response to the pandemic and its impact on markets, in addition to the rising specter of recession, behind these negative sentiments.

Figure 2. Which of the following best describes your intentions with regard to investing/M&A in North America in the year ahead?

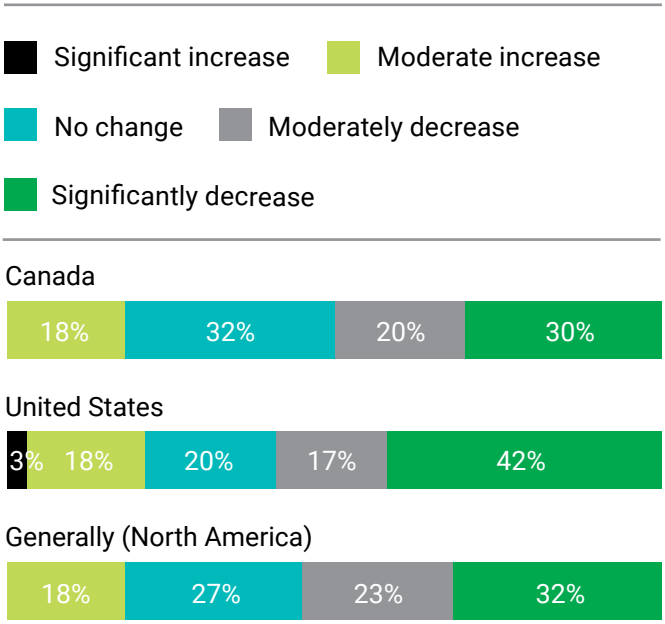


Figure 1. North American M&A

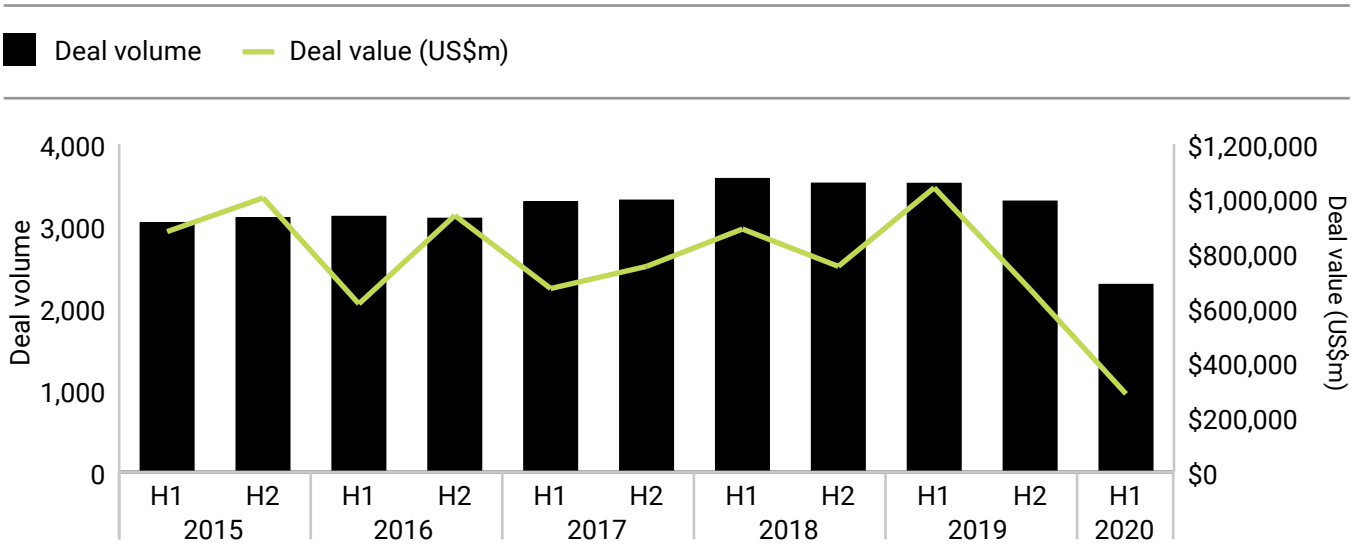
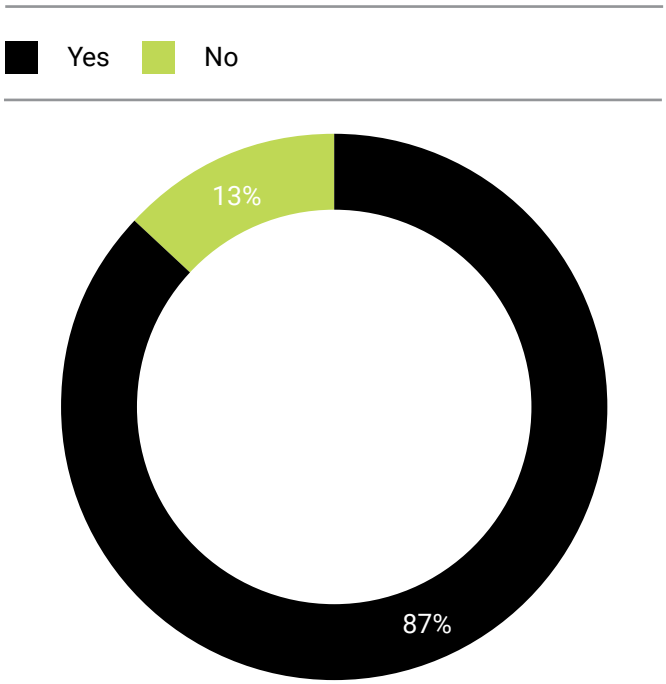


Figure 3. Has the recent spread of coronavirus negatively impacted your decision to complete M&A/ investments in North America?



COVID-19's impact on M&A and the general market in the first half of the year was swift, and the resulting unemployment rate and sudden draw down on lines of credit has created chaos in the debt markets. Debt funds are also dealing with mark downs in the value of their portfolios. All this has led to a severe liquidity crunch for a significant source of acquisition capital and investment bankers could no longer predict how much a buyer can borrow. As such, most prospective deals were put on hold.

William Chapman, Partner, Baker Tilly, United States, North American Corporate Finance Lead, Baker Tilly International

Most respondents (87%) say the pandemic and the subsequent uncertainty are driving decision-making. With that in mind, it will be interesting to see how (or if) opinions change once the current health crisis abates and the economies progressively reopen. Indeed, the pandemic has gotten in the way of basic deal logistics and has delayed sales processes, which is bound to hit overall M&A in the coming months and quarters, according to Mergermarket intelligence. Some respondents also mentioned that the upcoming US elections in November in tandem with the ongoing US-China trade war are adding to uncertainty and a general lack of enthusiasm toward the market.

M&A overview: The past 18 months

While COVID-19 may have led some dealmakers to slam on the breaks, the current rout is a continuation of declines that started mid-year 2019. Overall activity declined 6% by volume and 36% by value between 1H19 (a record US$1tn in deal dollars) and 2H19 (one of the lowest half years for deal values since 2015) due largely to uncertainty in global markets riled by political and economic tensions.

For 2019, M&A deal value in North America held steady, delivering US$1.7tn worth of deals across 6,493 transactions, only fractionally down on the US$1.6tn generated from 7,033 deals in 2018. Despite the slight dip, 2019 was nevertheless the third best year for North American dealmaking since 2008.

One ongoing theme across timeframes was dealmaker interest in TMT deals. The industry maintained its top spot in 1H20, accounting for 30% of volumes (678 deals) and 34% of values (US$96bn), respectively. Tech has become a particularly hot industry in recent years as corporations and private buyers look to bolster the digital advantages of their operations and/ or portfolio companies. Digital has so far played a key role in company successes during the pandemic, particularly in helping employees adjust to work-from-home situations and aiding in an uptick in eCommerce business and operations.

In terms of deal size, the once prevalent megadeals of 2019 are playing a less-predominant role in defining market activity. Only three such deals were announced in 1H20, for totals of US$40bn, compared to eight valued at US$287bn during the same period the year prior. There may be fewer large-scale transactions through the summer months and possibly to year-end as uncertainty dents the confidence needed to make bold strategic moves, according to Mergermarket intelligence.

Private equity activity has likewise been subdued. However, private equity firms are sitting on record amounts of dry powder, making them well positioned to make acquisitions once there is clarity on the outlook for the rest of 2020 and early months of 2021.

Land of opportunity?

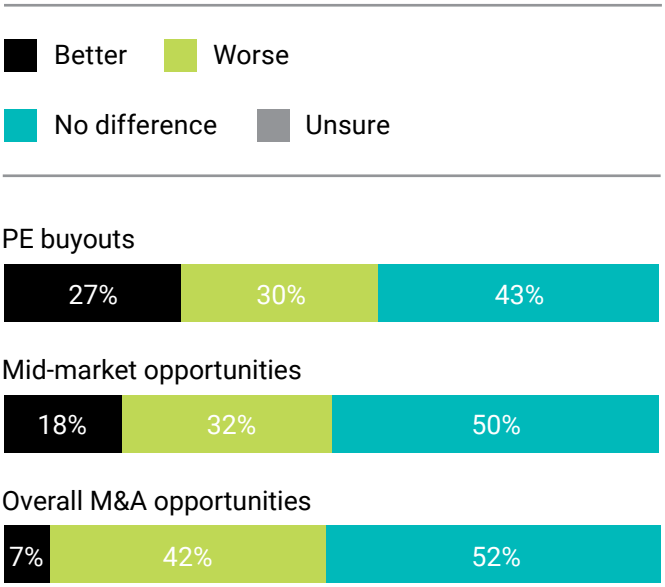
Given the confluence of challenges and uncertainties, it is unsurprising dealmakers are split on North America's prospects. More than half (52%) say that opportunities in North America are about equal with other regions, such as Europe and/or Asia-Pacific, while 42% actually say they are much worse. Only 7% say North American investments are better than other regions.

According to one respondent, recent geopolitical events and regulatory decisions, specifically in the US, have impacted investor perceptions. "Deterring foreign investments has caused many investors to remain additionally cautious and, in many cases, refrain from looking for opportunities in the region entirely," the respondent says.

Another respondent adds to this, saying that, "due diligence procedures, protocols and regulations vary somewhat in comparison to other regions in the Asia Pacific, Europe and Africa. Mainly US policies for foreign investments and scrutiny of deals are stricter."

Respondents are only slightly more positive toward deal opportunities in the mid-market (deals valued US$10m to US$500m) with 18% saying mid-cap deals in North America are better than other markets. Another 50% say they are about the same. Regardless of sentiments, North America's mid-market is where the bulk of dealmaking is done: 79% of deals in 1H20 were mid-market transactions as dealmakers search for deals that are reasonably priced and for businesses with proven track records of performance.

Figure 4. Generally, do you feel North America offers better or worse M&A opportunities compared to other regions?



Deal drivers

Distress-driven deals will factor heavily in M&A through the rest of 2020 and much of 2021, depending on how deep economic conditions sink. According to a respondent, one of the 83% who say distressed M&A will be the top driver for dealmaking in the year ahead, "distress-driven M&A will continue through this year and the next until financial conditions in North America and on a global scale have stabilized."

Other respondents mention that the impact on procurement and supply chain functions will be felt long after the pandemic subsides. Likewise, dealmakers are mindful that government measures will not provide support indefinitely. When stimulus is scaled back or slowed, distress is likely to arise in sectors and among companies that are unable to recover lost ground quickly, especially those that may have been suffering pre-pandemic.

Alongside distress-driven deals, respondents say current market conditions are creating opportunities for bargain buying, or at least discounted valuations and the potential to attempt to turnaround operations at the target or asset. According to one respondent, "The negative implications of the virus spread and North America being one of the most affected regions,

it has impacted business and trading conditions, supply chain mechanisms and financial stability altogether. Favorable valuations will be the natural outcome from the events."

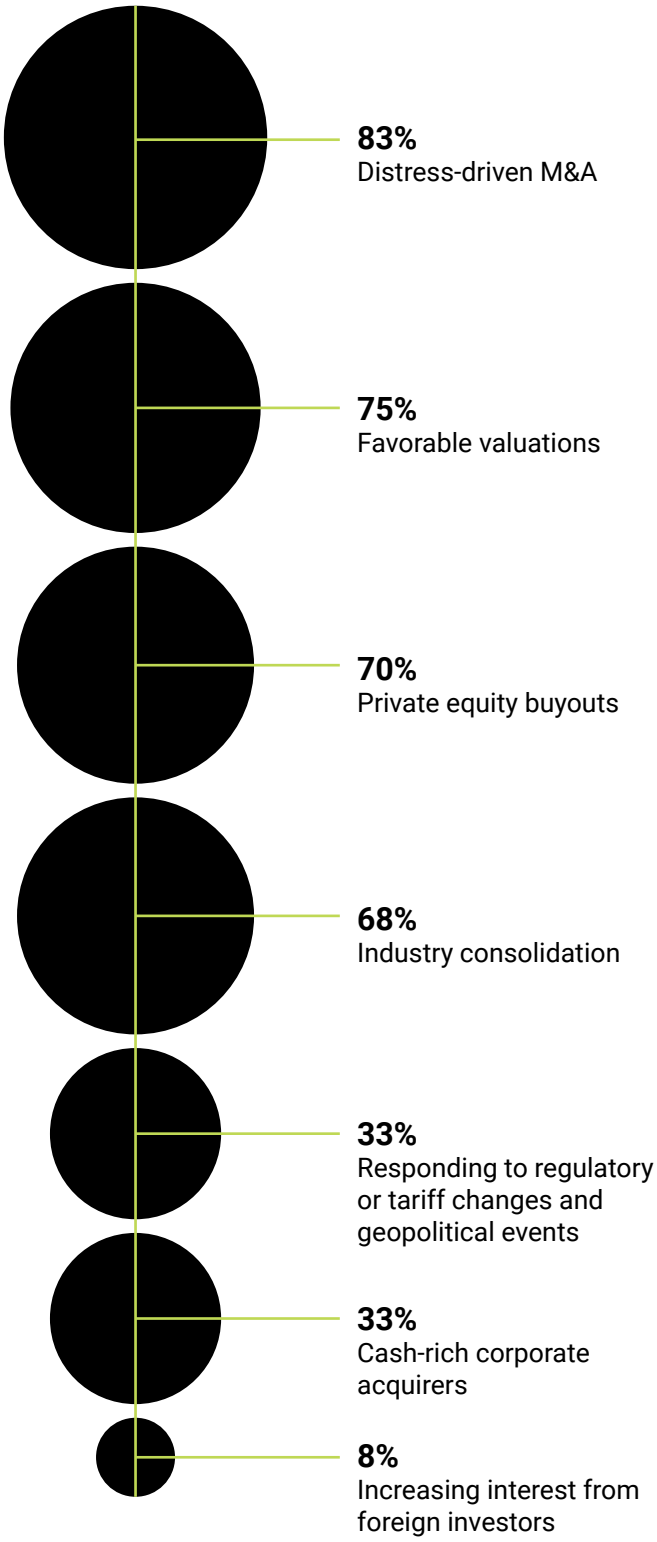
Consolidations will also drive deals as corporations take defensive measures, completing industry combinations to create stronger businesses and optimized operations and supply chains. According to one respondent, mergers within industries will increase as "industry consolidation will become a critical aspect to sustain the changing conditions and what is being termed as the new normal situation. To adapt to the working conditions and modifications with operational units and manufacturing protocols, consolidation will be the most viable option for many."

Private equity buyouts will also be a major driver of M&A, according to 70% of respondents. Respondents mention the financial firepower that private equity funds have on hand, with 27% saying that the buyout opportunities are better in North America than other markets, compared to general sentiment for the overall M&A market in the region.

Given the rough seas created by COVID-19, we believe that the next phases of M&A may possibly occur in four waves, which may potentially overlap. The first wave will involve deals currently underway – for companies that have been relatively unaffected by the pandemic. The second may largely be driven by distressed M&A and non-core divestitures. The third will be led by companies that performed well during the COVID-19 downturn and will be in the market in late 2020 and into 2021. The fourth and subsequent waves will bear some semblance of a return to normal.

Michael Milani, Executive Managing Director, Baker Tilly Capital, United States

Figure 5. Which of the following will be the main drivers of M&A activity in North America in the year ahead? (Select all that apply)



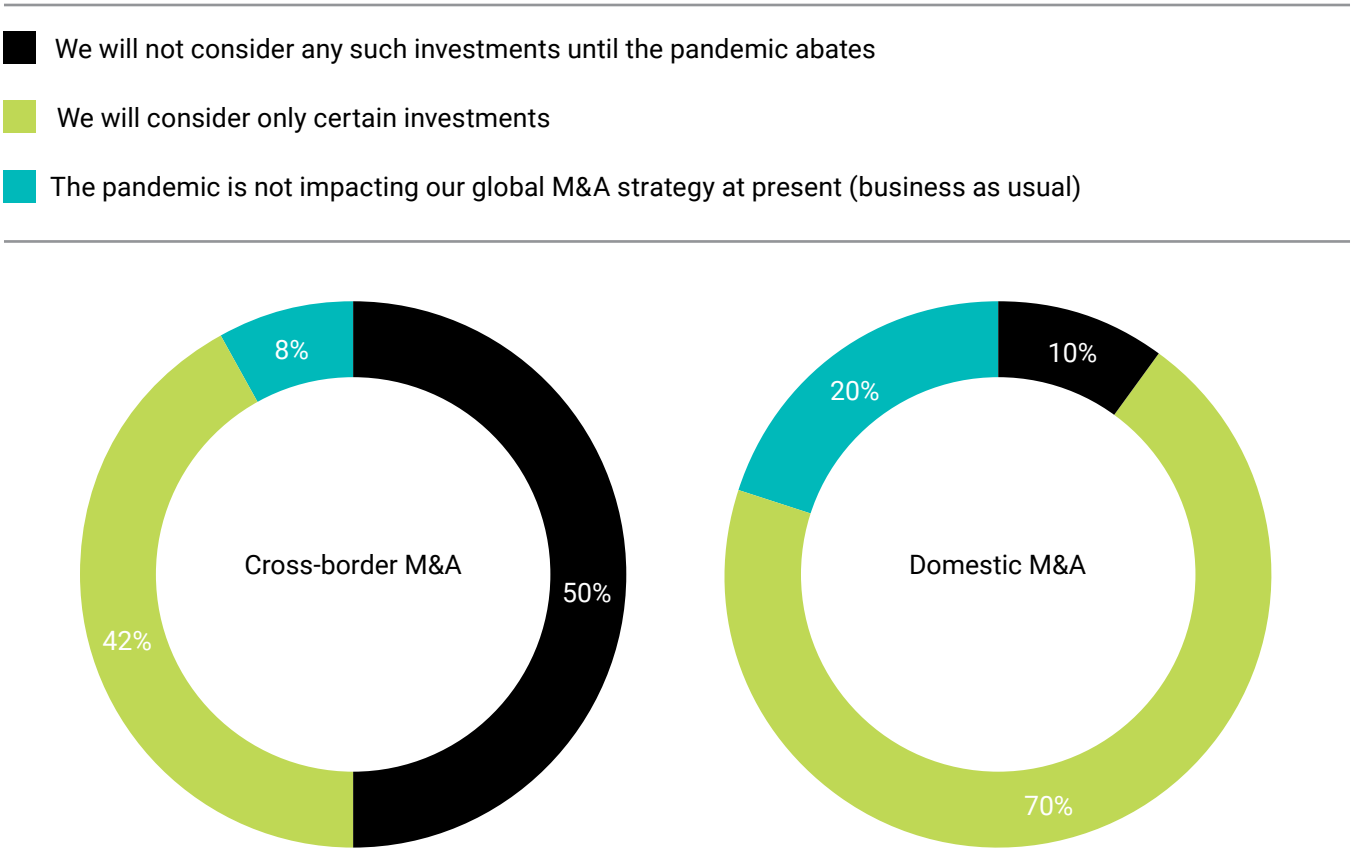
Global M&A: Deeper into the hole?

After nearly a decade of growth, global M&A plummeted through the first half of 2020 and is likely to remain subdued for the rest of the year. Deal totals decreased 33% by volume (6,789 deals) and 53% by value (US$888bn) from record levels in 1H19 (10,142 deals worth US$1.9tn). While some market participants say a bottom to the economic hole is in sight, others are more skeptical, saying that past downtrends of this nature indicate that things will get worse before they get better.

The impact on global M&A will likely be felt hardest on cross-border transactions. Cross-border M&A in 1H20 declined 36% in volume and 46% in value since 1H19 and respondent sentiments show it may have further to go: 50% of respondents say they will not consider international M&A until the pandemic abates.

For dealmakers that have not completely ruled out M&A, transactions will remain a domestic affair for the foreseeable future. Most dealmakers (70%) say they are not completely ruling out deals in their home markets and another 20% say the pandemic is not impacting their M&A strategy toward domestic deals.

Figure 6. What will be the impact of the ongoing pandemic regarding your intentions to complete cross-border and domestic deals in the year ahead?



Spotlight: **Private equity**

Private equity buyout activity is set to takeoff, with respondents anticipating heated competition between private and corporate buyers in the year ahead.

Private equity, which enjoyed a robust start to the year, will be tested in the months ahead. In line with broader trends, private equity buyout activity in 1H20 showed noticeable declines (33%), with only 545 deals compared to 817 in 1H19. On the value side, buyout totals dropped 52% from US$145bn in 1H19 to US$70bn for 1H20. Since 2H19, volumes declined 20% with values dropping 46%. With the primary market for leveraged loans temporarily shut down, the buyout decline of recent months could continue to challenge PE's ability to deploy capital in the quarters ahead.

Yet, while M&A markets have slowed as investors evaluate the full impact of COVID-19 on the economy, private equity firms are sitting on record amounts of dry powder and could be well positioned to make acquisitions. As previously mentioned, private equity buyout activity was one of the top drivers for dealmaking, and 48% say this activity will increase in the year ahead.

Elaborating on these expectations, one respondent says, "I think the main reason for the increase will be the distressed sales and the valuation that fits into the expectations of PE funds." Another respondent expands on this, adding that, "In the year ahead, private equity activity will increase somewhat as capital needs will increase simultaneously. Other financial institutions will be restrictive with their services, so PE funds can capitalize on the situation and avail valuable returns on the short- and long-term basis."

Respondents anticipating a decrease or unchanged level of investment from private equity say that these buyers may sit out the near term in order to await visibility on the economic outlook and formulate strategies. According to one respondent, "In the year ahead, I think there will be more planning, rather than executing strategies, because they need to assess the conditions and viability of sales. Overall, they will look for functional conditions to proceed with planned activities."

Figure 7. North American PE buyout trends

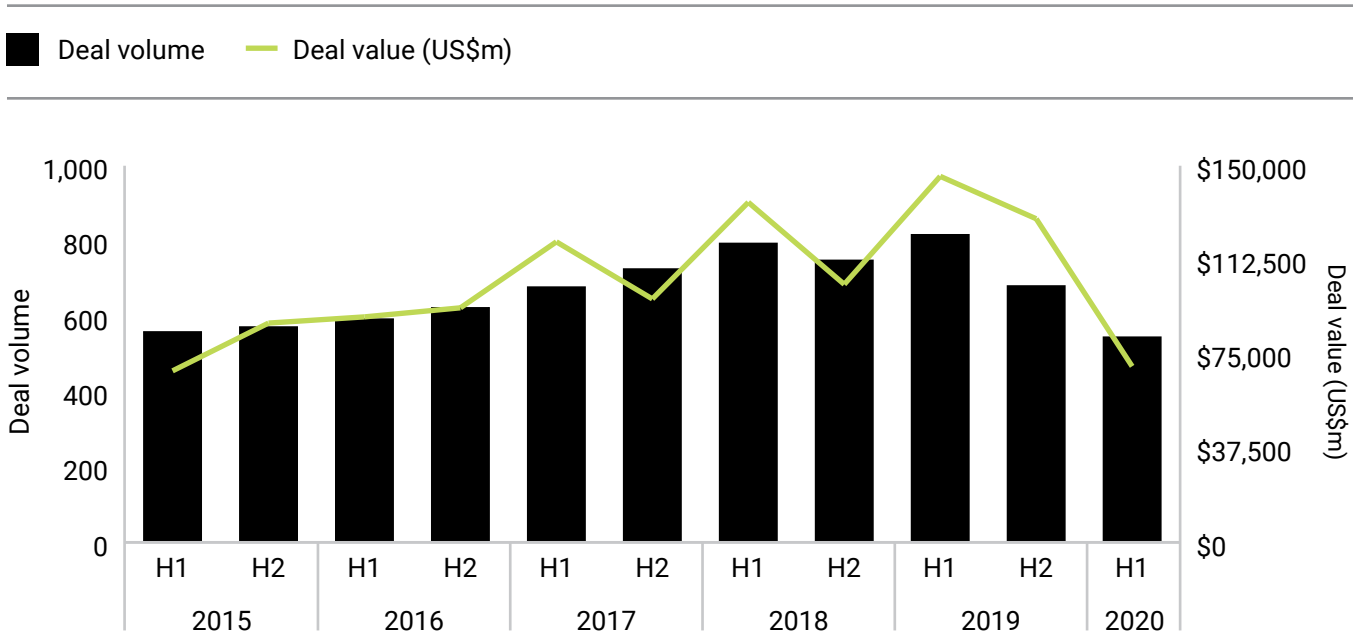


Figure 8. What do you expect to happen to the level of private equity activity in North America in the year ahead?

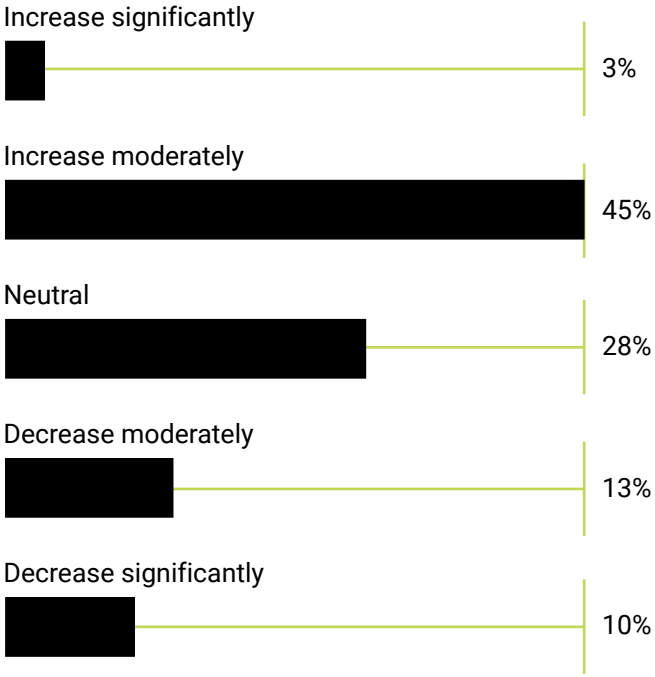
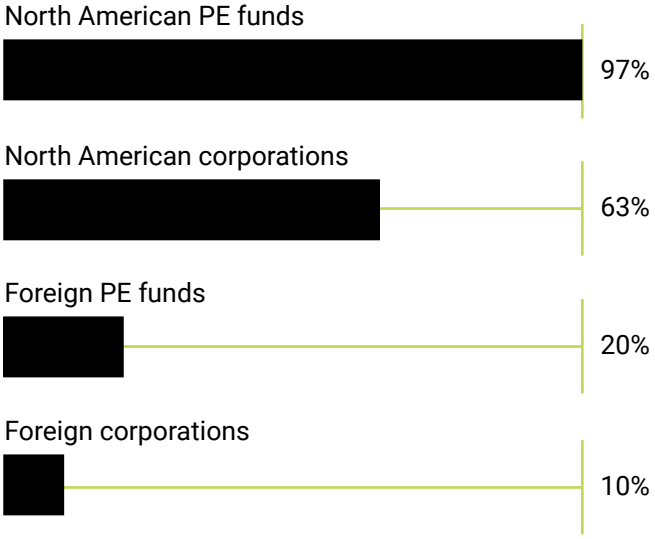


Figure 9. Which of the following buyer groups do you expect to create the most competition for assets in North America in the next 12 months? (Select all that apply)



Driving competition

With capital to deploy, private equity buyers could up the ante for transactions in the year ahead. Historical data shows that PE firms have been active participants, accounting for 20% of deals and 13% of values since 2015. Those numbers increased to 23% of deals and 24% of values in 1H20.

Also notable, HY-on-HY buyouts declined to a lesser degree than corporate transactions by value as financial sponsors continue to seek opportunities to deploy capital. Corporate deal values dropped 79% in 1H20 compared to 1H19, compared to only 58% for PE.

Dealmakers see this as a growing trend, with 97% of respondents saying private equity buyers will create the most competition for assets in North America, compared to 63% for corporate buyers. Even among international investors, foreign private equity (20% of respondents) will lead inbound investment over corporate buying (10%).

Economic fall-out from COVID-19 has seen private equity shifting focus from originating new deals to stabilizing portfolio companies. However, continued access to record levels of dry powder combined with a positive outlook toward global capital markets indicates PE investors may not sideline investment activity very long. As with past recoveries, mid-market deals will be the first to emerge from the downturn, and PE investors are positioned to take advantage of today's favorable valuations. This trend will once again illustrate the resiliency and attractiveness of mid-market businesses to PE investors.

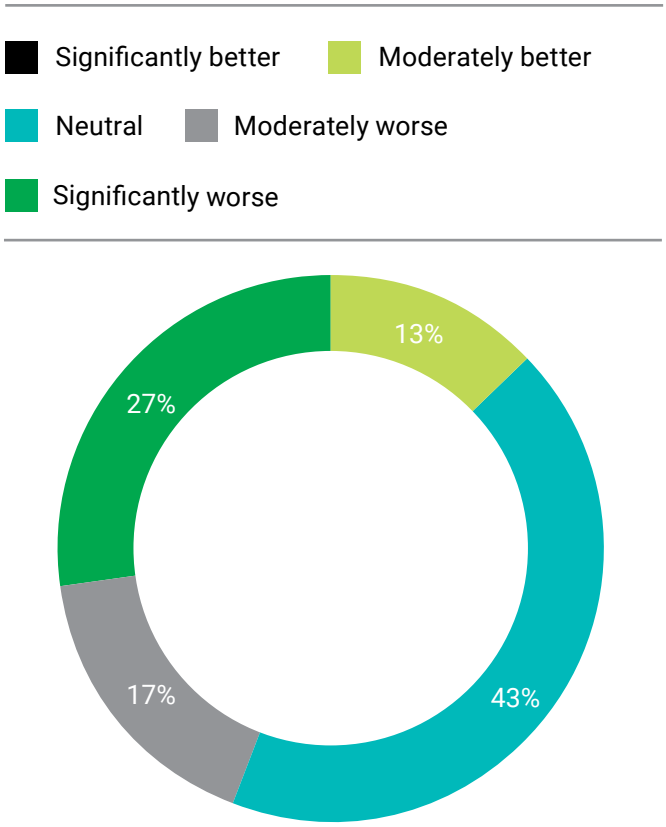
Scott Moss, Partner, Cherry Bekaert, United States, Global Private Equity Lead, Baker Tilly International

Exit markets

Dealmakers are less enthusiastic about exit prospects in North America in the near term. Compared to Europe and Asia-Pacific, 13% of respondents say the exit market for private equity investments is better in North America. However, most respondents (44%) agree that exit opportunities in North America are worse than other markets. One respondent says the impact of the pandemic will also play negatively against valuations of portfolio companies under PE management, noting that, "I think funds need to wait longer for them to achieve the desired results in terms of gaining the expected value for their investments."

Another goes on to note that the high degree of uncertainty and volatility is less than ideal. "The level of certainty expected regarding the IPO market is not present. The uncertain conditions are hardly effective for decision-making and since PE funds prefer faster exits, I think the exit market in North America is hardly preferable," the respondent says.

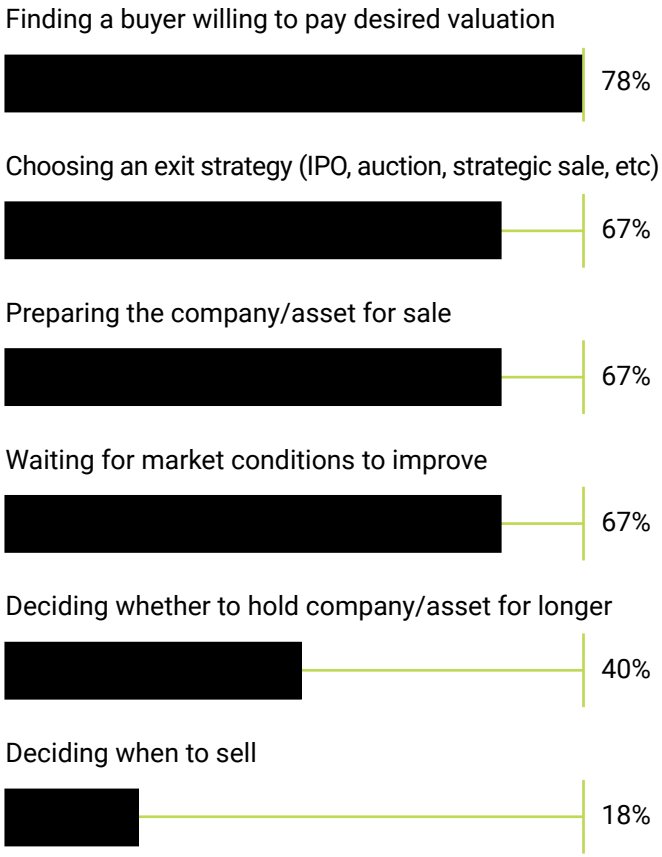
Figure 10. Generally, how does the exit market for private equity investments in North America compare to other markets globally?



An equally large percentage of respondents (43%) say that exit conditions in North America are about the same as – or at least no worse than – elsewhere in the world. Most respondents recognize that no market has been spared the negative impact of Covid-19. Says one respondent, "The conditions seen in the exit market resemble those of other markets globally. The risks, valuation anticipation, criteria for exits and strategies follow the same course, along with the nature of agreements and the completion timelines."

Respondents also highlight the challenges facing private equity firms as they attempt to exit investments in the year ahead. Finding a buyer willing to pay the desired valuation (78%) was the top challenge. Choosing an exit strategy (IPO, auction, strategic sale or otherwise), waiting for market conditions to improve, and preparing the company/asset for sale tied as the second-biggest obstacle facing private equity firms.

Figure 11. What challenges are private equity firms likely to face pertaining to exiting their investments in the year ahead? (Select all that apply)



Deal challenges in the year ahead

Respondents highlight recession, the upcoming US elections in November and geopolitical concerns as the top pitfalls for dealmakers in 2H20 and the year beyond.

Even as the US economy beings to reopen, respondents anticipate a challenging outlook for the rest of 2020 and possibly deep into next year. Competition between private and corporate buyers (as mentioned in the previous section) will be an obstacle, however, dealmakers also highlight several other factors that will be top of mind as they search for opportunities.

Recession

Fears over how deep the current recession will be and the overall impact of COVID-19 lead respondent sentiments. Echoing opinions of the large body of dealmakers, one respondent says, "In the US, it will be a risky situation, with newer risks emerging due to the recession… While the health crisis is expected to be under control by the end of the year globally, the influence on businesses and operations may continue beyond this point."

Business owners previously focused on exiting will likely be more focused on stabilizing businesses and returning to a new normal. Challenges are also likely to come between buyer and seller in terms of establishing value. Structure will likely change, and more contingencies will be in place and a greater level of planning will occur in the pre-LOI stage. Finally, the credit markets will likely tread carefully to minimize exposure until businesses can prove that they have returned to a sustainable level of earnings.

Christopher Hines, Partner, Blum Shapiro, United States

Other respondents question the stability of companies and target assets, even those that are able to survive the COVID-19 situation. "For the rest of 2020 and even next year, the biggest challenge would be dealing with the targets themselves, as they are posing uncertain numbers and holding relatively unknown future prospects. This largely depends on the industry of operations and their sustainability potential," says one respondent.

US elections in November

Looking beyond the summer months, many respondents say the US elections to be held in November will be more of a bane than a boom for business and M&A. Almost half (48%) say the elections will have a negative impact on M&A in the United States.

"Altogether, the impact will be widely negative, given the lowering economic prospects and the lack of control on the pandemic situation. Recent changes in political views have complicated the situation further and unless we see some positive instances of trust being portrayed, US markets will pose some tough challenges for PE and corporate investors," says one respondent.

Another goes on to say that the "upcoming US elections will have a very negative impact because there are many challenges that are being faced, such as the economic problems and the global conditions that have led to the recession. Response to these by contenders will determine the effect on how further investments are perceived in the region."

Geopolitics and protectionism

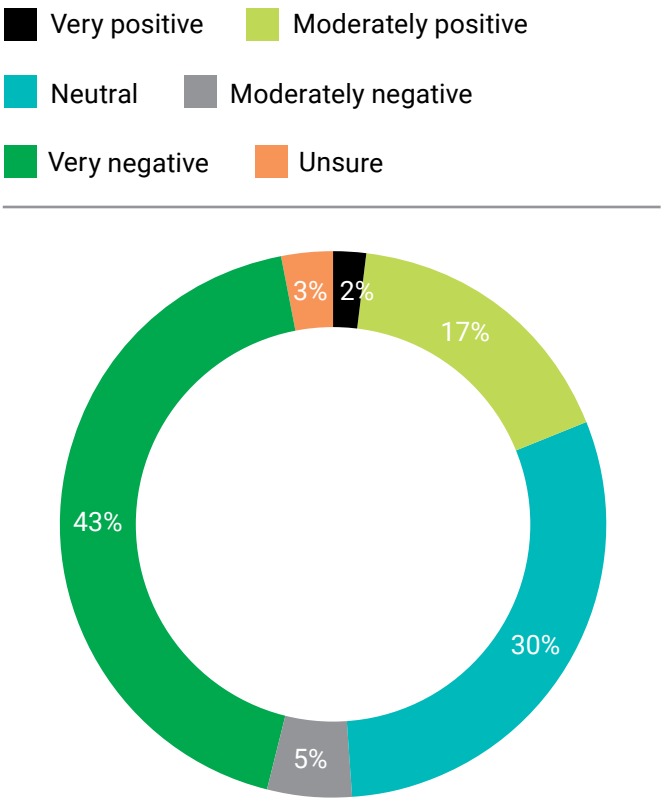
Large numbers of respondents also point to geopolitical concerns, such as the ongoing trade war between the US and China, as a constant in their decision to invest in North America. According to one

respondent, "I think one of the biggest challenges is anticipating the outcome of the trade war situation between China and the US. The negativity between the two countries has escalated further after claims in relation to the virus have been raised by the US President."

Over the past year, the US has announced new retaliatory trade restrictions and tariff hikes on foreign steel, aluminum and more than US$360bn of Chinese goods. These measures, however, have proven to be a burden on US companies dependent on imported goods and parts, chipping away at profits while negatively impacting business investment, according to news reports.

In this vein, protectionism could be a challenge as regulators begin to scrutinize foreign investments more heavily to safeguard domestic industries. One respondent says that policies favoring protectionism are becoming more prevalent not just in North America but globally and could have a profoundly negative impact on cross-border dealflows worldwide. "Over the past few years, we have seen changes in regulations and strictness of authorities in assessment of potential M&A deals. Anti-trust rulings have been stricter, and there could be further challenges as were seen in Europe with the data protection laws," says the respondent.

Figure 12. What impact will the upcoming US elections have on M&A in the United States in the year ahead?



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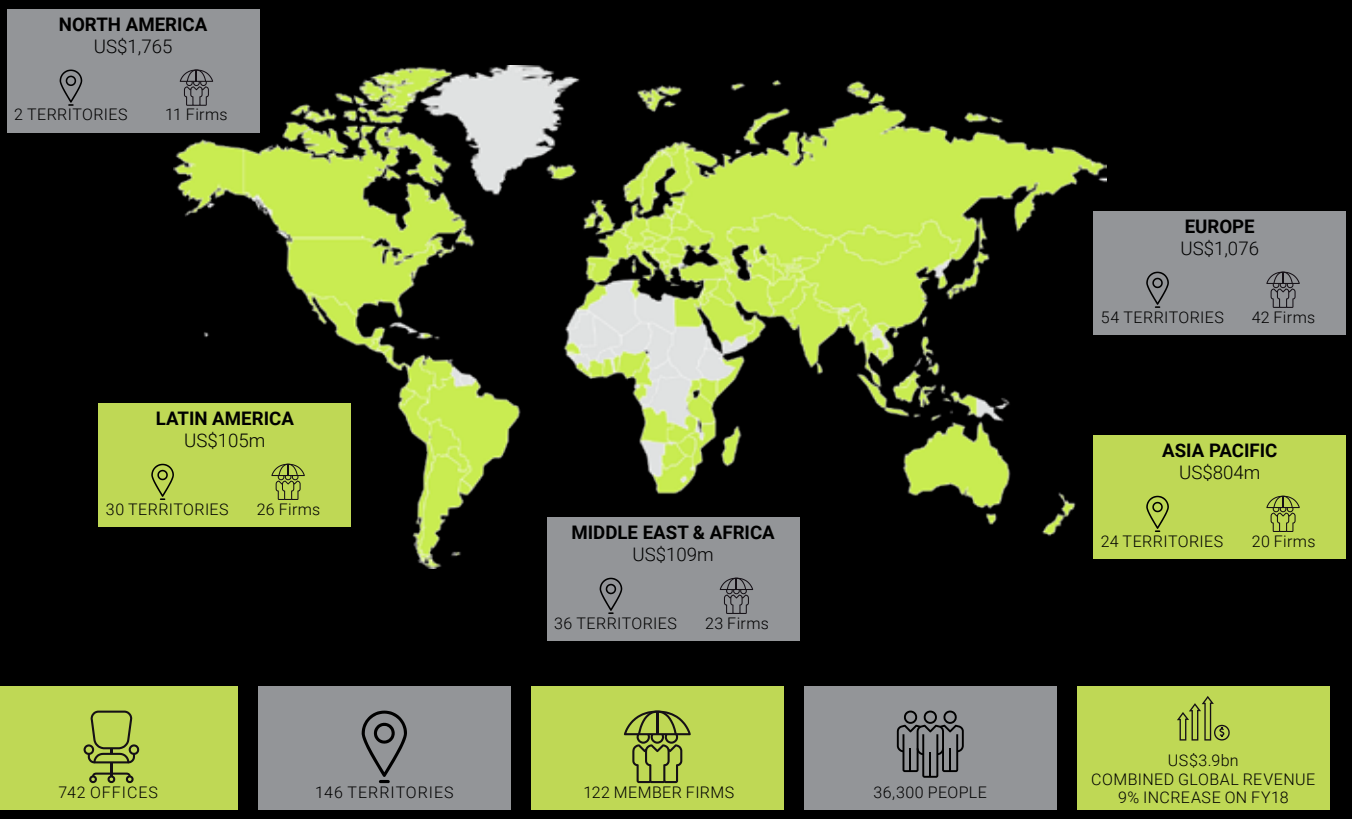

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