

M&A Insights

H1 2020

Adjusting
to adversity





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A market utterly transformed as M&A deals stall

The Covid-19 coronavirus pandemic has brought the global M&A market to a juddering halt and is likely to radically change dealmaking for the foreseeable future.



41%

Decrease in global deal value
H1 2020 vs. H1 2019



16%

Decrease in global deal volume
H1 2020 vs. H1 2019

Note: Figures in this report represent deals announced between 1 January 2020 and 30 June 2020.

Data provided by

REFINITIV™


The figures for H1 make bleak reading:

- global deal value fell by 41%
- the number of transactions declined by 16%
- megadeals over USD10 billion were down by 48%, while those over USD5bn were 25% lower

This impact was particularly severe in Q2, as the crisis peaked.

But even on a first-half basis it was dire, hitting all regions and sectors.

Domestic deals, which helped the market to keep ticking over in the latter part of 2019, declined in value by 50% and in number by 12%.

Cross-border deals continued their already steep decline, with deal value down 15% and volume 24% lower.

This partly reflects the way investor confidence has been hit.

“Safety first” is the watchword for most businesses. The priority is to conserve cash and protect revenue streams rather than investing in M&A.

Equally, it reflects the logistical difficulties of transacting in a “locked-down” world. Megadeals that are still completing are taking an average of 300 days to close. Last year, the average was 240 days.

Q3 may well see these themes intensify, especially with a severe recession in prospect.

And yet, there are reasons to believe that the M&A market will revive, although not to the level seen in the record-breaking last cycle, which began in early 2014.

Reasons include:

- a likely rise in distressed deals and restructurings as vulnerable businesses look for liquidity
- an upsurge in tech-related deals as digital transformation accelerates in sectors such as the life sciences, retail and financial services
- the search for cost-efficiencies through collaborations, joint ventures and consolidations

There is one other vital factor. Buyers (notably private equity funds) have plenty of dry powder to deploy and continue to assess opportunities, once buyer and seller price expectations line up. Credit markets also remain pretty robust.

The market will revive, but will continue to look very different.

For more information, please contact:



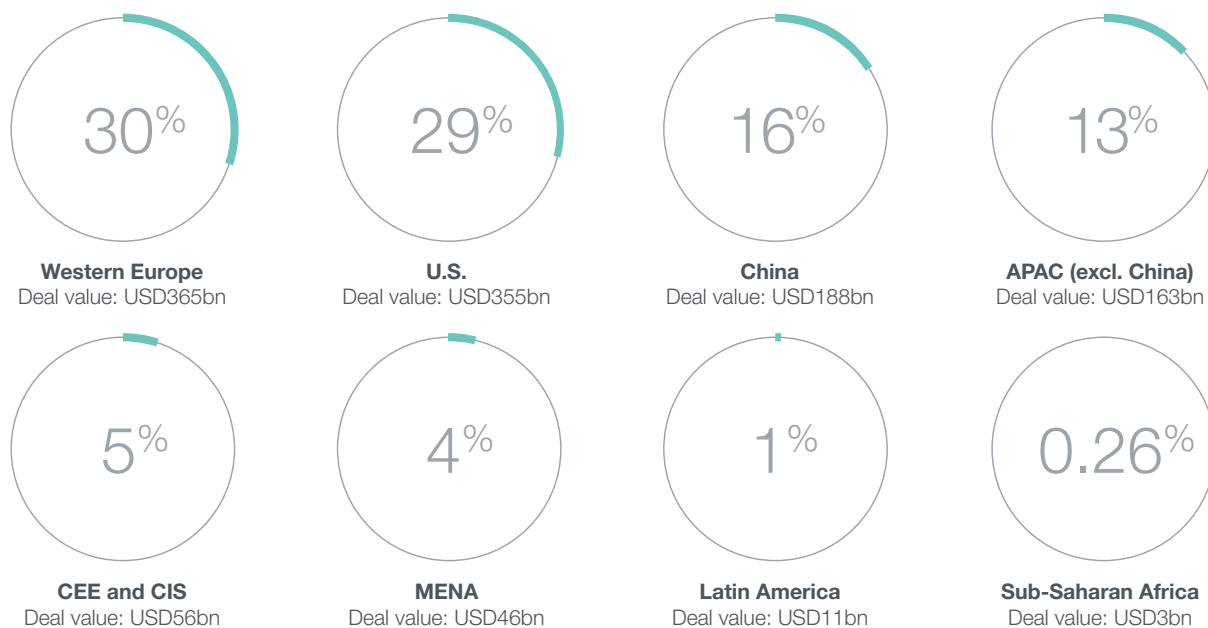
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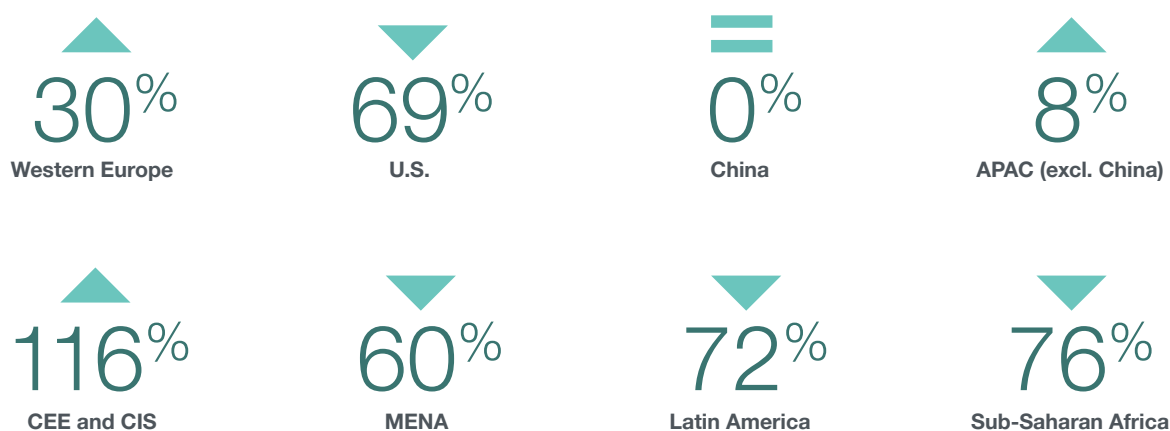
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Global M&A snapshot

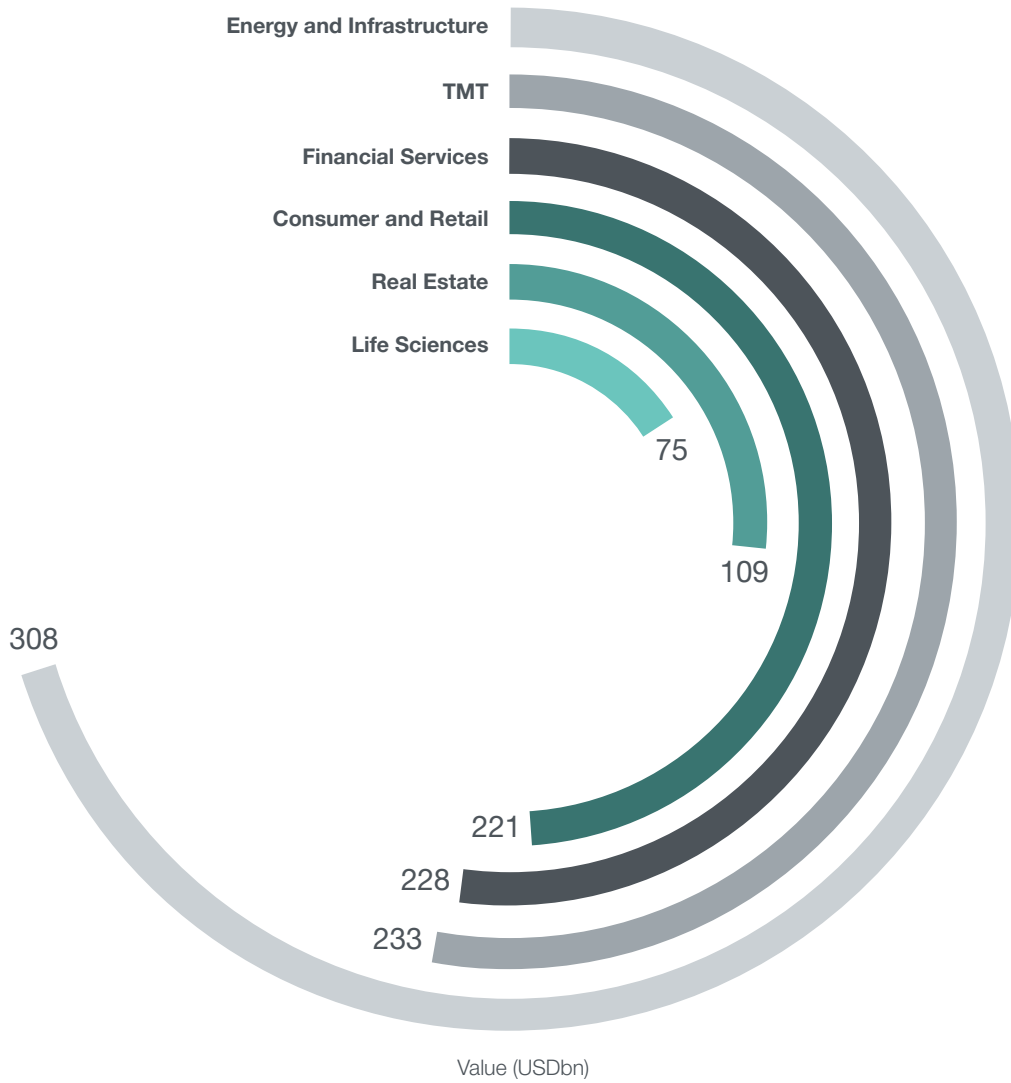
Split of global M&A deals by value



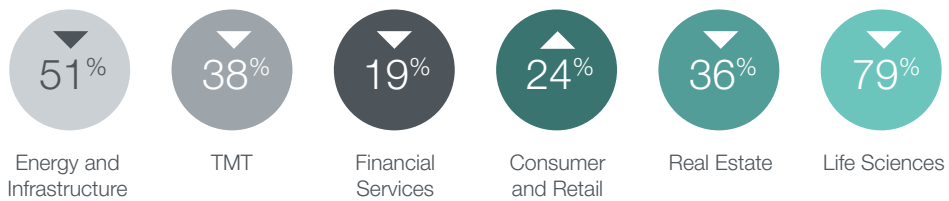
% change from H1 2019



Global M&A activity by sector, H1 2020



% change from H1 2019



Pipeline gaps and digital will drive life sciences deals

Often seen as a safe haven sector in times of crisis, the life sciences have not only been centre stage during the Covid-19 crisis but are riding it out well.

Life sciences megadeal volume

USD10bn+

H1 2020: 0
H1 2019: 8

USD5bn+

H1 2020: 3
H1 2019: 10

Life sciences share prices are back to 2019 levels, having fallen sharply at the outset of the pandemic.

However, transaction value and volume have gone into reverse, falling by 79% and 15%, respectively. Some key deals have been delayed, including the planned merger of Pfizer and Mylan.

The slowdown in deals looks particularly stark coming after a very strong 2019, where the USD78bn Bristol Myers Squib acquisition of Celgene became the ninth largest deal on record.

R&D badly hit by the pandemic

The pandemic has seen many life sciences companies go flat out to develop anti-viral tests and vaccines. In wider consumer health, they have focused on safety equipment, disinfectants and hand gels.

With key research staff redirected to this work, other R&D programmes have been badly hit and, in an effort to protect participants from the Covid-19 coronavirus, clinical trials are at a near standstill.

Companies could therefore face major gaps in their R&D pipelines in future, disrupting traditional funding models. Filling the gaps could involve:

- M&A
- consolidation deals
- strategic IP collaborations and portfolio reshuffles, driven by cost cutting

Digital transformation accelerates

The lockdown has placed a huge premium on technologies that allow healthcare professionals and their patients to interact remotely. This steep rise in adoption seems unlikely to be reversed, even once lockdown measures are eased globally. We also expect increased use of technology to optimise processes and reduce costs. Diagnostics have been one of the most active areas, and we expect to see rapid adoption of key technologies, such as:

- AI/Big Data, not least in a bid to speed up drug discovery
- 3D printing
- telemedicine

Partnerships between pharma companies and non-traditional industry players like big tech will be achieved through M&A or other forms of alliance, with the pandemic speeding up this trend.

Digital transformation will extend this deal activity for some time. However, we may see more collaborations rather than cash-driven transactions due to lack of funding.

In the shorter term, we could also see a spike in disputes over agreements done in haste during the crisis, with companies testing Force Majeure and material adverse change clauses.



“With key research staff redirected to this work, other R&D programmes have been badly hit and, in an effort to protect participants from the virus, clinical trials are at a near standstill.”

Traditional retail faces fight for survival

Few sectors have been harder hit by the Covid-19 crisis than retail. With the exception of pure online grocery retailers, there have been almost no winners from the pandemic.

Traditional retailers have been driven to close stores and furlough staff, while desperately trying to preserve cash. Big names have been forced into administration and those with a poor online presence (or none at all) face a fight for survival.

Big bricks and mortar supermarkets have seen footfall drop dramatically due to social distancing.

Even online clothing retailers have seen declining sales, with locked-down consumers losing their usual appetite for fast fashion.

In this febrile environment, it is almost impossible to value assets and the impact on transactions has been profound as the crisis escalated. Despite this, the numbers tell an interesting story:

- H1 deal value increased by 24%, while volume fell by 21%
- Q2 transaction value increased by 29%

The increase in value is widely driven by the USD81bn Unilever unification transaction, which has boosted the numbers during this uncertain period.

Retail's rapid transition

There will be no early let up.

With recession looming in the autumn, many consumers are likely to rein in spending or divert it to home and healthcare products. The impact on spending will grow as furloughing ends and unemployment climbs.

In economies like Germany where shops have already re-opened, consumers seem to be staying away, with safety measures undermining the shopping experience they once enjoyed.

Other likely trends include:

- faster decline of high streets, with retailers closing stores to focus on high-profile outlets where rents have been renegotiated
- a move by supermarkets away from convenience stores and back to big edge-of-town sites, where shoppers can visit less frequently but get wider choice under one roof
- government measures to protect food security and supply chains

Full steam ahead for digitalisation

The crisis has sped up the digital transformation of retail by some five years, and this is where deal activity is likely to grow fastest, including:

- collaborations between tech delivery platforms and bricks and mortar retailers
- investment in key technologies such as AI, the Internet of Things and drones
- established brands teaming up with disruptive partners to communicate environmental and social values to consumers online and through social media
- distressed deals, with financial buyers seeking buy and build opportunities, pairing struggling brands with delivery platforms to give them new life online

Consumer and Retail M&A activity, H1 2020

▲
24%

Increase in deal value
vs. H1 2019

▼
21%

Decrease in deal volume
vs. H1 2019

Fintech deals enter temporary lull after Q1 surge

The start of the year saw a surge in ever-larger fintech deals around the world, with every expectation that this trend would continue.

With valuations becoming increasingly inflated in Q1, we were beginning to see financial institutions opting to build their own fintech capabilities or enter into collaborations, rather than buying promising tech companies outright.

Changed dynamics

The Covid-19 crisis has changed the dynamics. Dealmaking has entered a lull, although one that looks temporary. Potential acquirers, including private equity funds, are still assessing deals and doing the legwork, ready to move quickly once the economic outlook becomes clearer.

Valuations are also coming down and the impact of “down rounds” is becoming increasingly relevant, with companies seeking equity financing at valuations below previous funding rounds.

Well-funded, more mature tech companies are still in a position to buy.

However, given the current economic outlook, fintechs’ (particularly early stage companies’) priorities are shifting, with more businesses looking to hunker down and ensure they have enough runway before their next funding round.

Those deals that are done are likely to be opportunistic and we see evidence of that in the recent speculation about Metro Bank acquiring UK P2P lender, RateSetter or Western Union’s reported approach to MoneyGram.

Some areas of the market remain particularly hot, not least the intersection between ecommerce and payment systems.

Facebook, for instance, is launching payments services in a number of markets. Alongside PayPal, Facebook also joined the latest funding round for Gojek in Indonesia, securing a small stake in GoPay.

Activity likely to resume

The pandemic has sped up the adoption of online financial services, even among previously reluctant consumers. Traditional institutions will need to respond to compete with dedicated online challenger banks.

In the medium term, that points to a resurgence in strategic M&A transactions. Until then, investors are likely to be more cautious, with an emphasis on minority investing, consortium deals and collaborations.

Q1 standout deals included:

- Visa’s USD5.3bn acquisition of the start-up, Plaid
- LendingClub becoming the first fintech to buy a U.S. regulated bank
- Worldline buying rival Ingenico for USD8.6bn
- The USD7bn purchase of Credit Karma/Intuit

Global trends in private M&A: Covid-19 update

Analysis of private M&A deals signed so far this year shows just how fundamentally the market has changed since the onset of the Covid-19 crisis.

Over the last eight years, we have analysed around 1,300 private M&A deals that Allen & Overy advised on globally.

Usually, we report on M&A trends annually.

But the Covid-19 pandemic has brought about such significant changes in market practice that we have

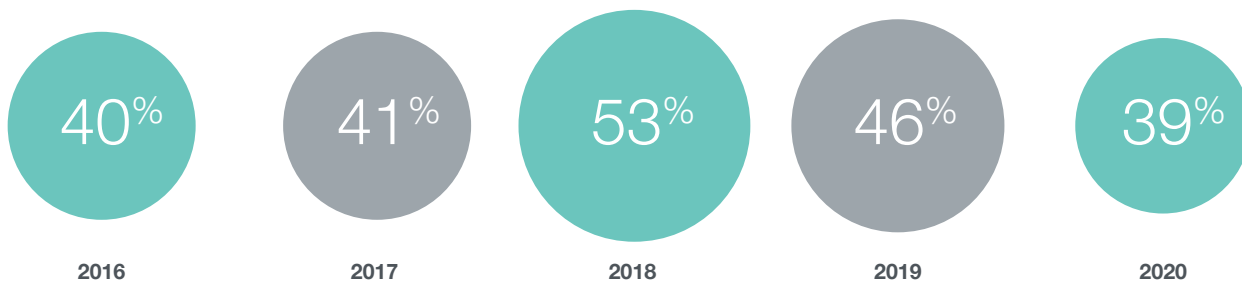
produced a special update comparing deals signed so far this year with those signed in 2019 and previous years.

Dramatic decline in buy-side competition

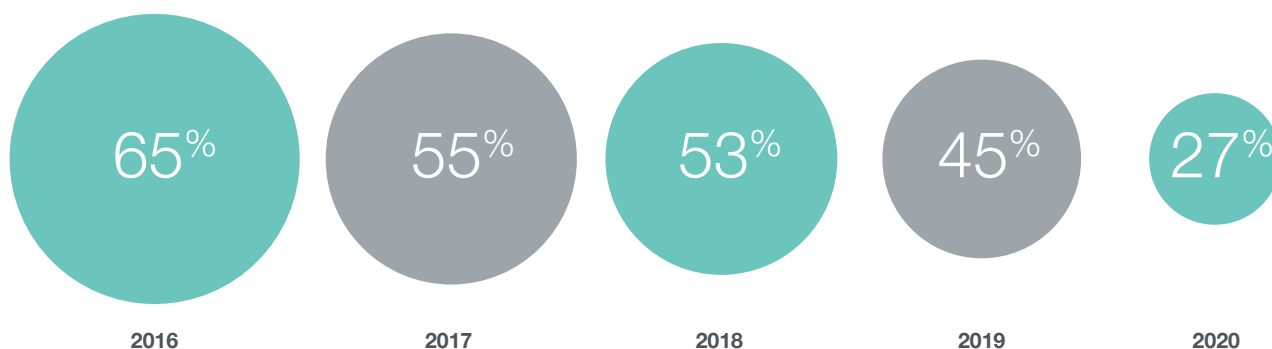
When the pandemic first hit, many deals close to signing went ahead, though some in sectors that looked set to be badly affected were put on hold.

A number of auction processes still at an early stage saw competition between bidders diminish almost immediately, as doubts over valuations grew and as corporates refocused on cash preservation.

Deals conducted by auction



Highly competitive auctions





Deal structures changing with slight uptick in distressed M&A

Many potential M&A investors have been thinking about using deal structures that allow them to realise the benefits of M&A without full exposure to the downside.

In particular, parties are seeking to solve valuation issues, while also mitigating solvency risk and, in some cases, committing less funding. Just as in the wake of the financial crisis, investors are debating whether to acquire, invest or collaborate.

We already have some evidence that deal structures are changing. This includes:

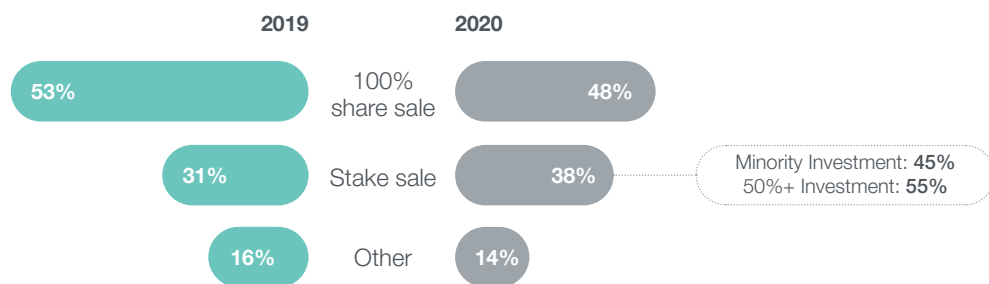
- an increase in stake sales, including minority investments
- some planned acquisitions being turned into long-term collaborations or supply arrangements
- a slight uptick in distressed M&A, with more likely to follow

Pre-Covid deals in heavily impacted sectors unravelling

The vast majority of deals that were signed pre-Covid are proceeding as expected. However, some in the most heavily impacted sectors (including retail, travel and tourism) are unravelling or being renegotiated.

Some buyers are hoping that “material adverse change” provisions will take them out of deals, but many are also running an alternative argument: alleged breaches of pre-closing “ordinary course” covenants.

Deal structure



In other deals, buyers are getting creative when deal terms provide no obvious get out. The outcomes of these situations also vary, and some are still to play out through litigation or otherwise.

But they point to areas of an M&A deal that might merit more focus during negotiations over the coming months, particularly if a second wave of Covid-19 hits.

Sellers now have laser focus on execution risk

With sellers now focusing intently on execution risk, a buyer able to offer an unconditional deal will be at an enormous advantage. In higher value deals, where some degree of conditionality is almost inevitable, substantive deal risk is being heavily scrutinised.

Certainty of funds is also critical, and financing conditions have become even rarer.

And termination rights linked to material adverse change or material breach of warranty are scarcer than ever.

One surprise finding is that we have not so far seen a coronavirus-related increase in the use of reverse break fees. But if more buyers refuse to complete despite conditions having been satisfied, more sellers may start pressing for these.

Governments and regulators moving the goalposts

Over the last few years, we have seen a swing towards protectionism, particularly in the U.S. and Europe. Covid-19 has accelerated and expanded that trend.

Many governments are introducing, or increasing the scope of existing, foreign direct investment regimes, fearing:

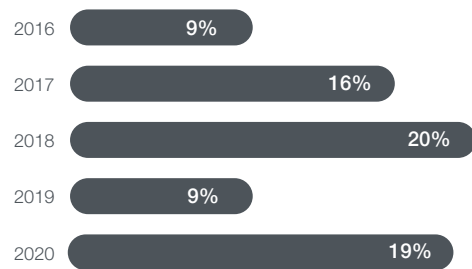
- threats to national security
- loss of control over critical infrastructure
- the potential for opportunistic acquisitions, especially by buyers affiliated with a foreign government

The pandemic is also impacting deal timetables, as the ability for some authorities to conduct merger reviews has become more constrained.

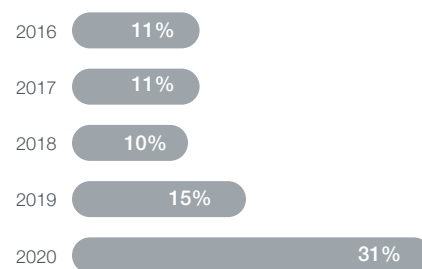
This means it is taking longer than ever to close M&A deals.

Long-stop periods in our 2020 deals ranged from one to 24 months, with an average period of seven months. That is one month longer than the equivalent period in 2019.

Earn-out



Deferred consideration



Reason for earn-out



- Bridge valuation gap **83%**
- Incentivise management **17%**

Reason for deferred consideration



- Payment contingent on future event **30%**
- Vendor finance **30%**
- Security for warranty/indemnity claims **20%**
- Management retention **10%**
- Other **10%**

Valuation challenges turn pricing structures on their head

Companies have found it difficult to assess, with any certainty, what impact the pandemic will have on their future earnings. Without reliable financial projections, it is very hard to price a deal.

Consequently, where deals are going ahead, parties are looking to pricing structures that will help to mitigate risk and bridge valuation gaps.

In a marked increase on previous years:

- half our 2020 deals involved an earn-out or deferred consideration structure
- half (excluding private equity exits) involved a price adjustment

The financial metrics involved have changed too.

As a result of these “future pricing” structures the risk of disputes has

increased, making dispute resolution mechanisms especially important at the moment.

Significant movement in warranty packages

Much market commentary has suggested that buyers might succeed in obtaining stronger warranty and indemnity packages in the current climate.

But close analysis of our deals shows that, while most trade sellers are still providing a decent set of operational warranties, they are pushing back hard on warranty repetition, buyer’s awareness and liability caps.

We have also seen a temporary reversal of the trend towards W&I insurance, as underwriters seek to exclude liability related to the one issue that is currently top of mind: Covid-19.

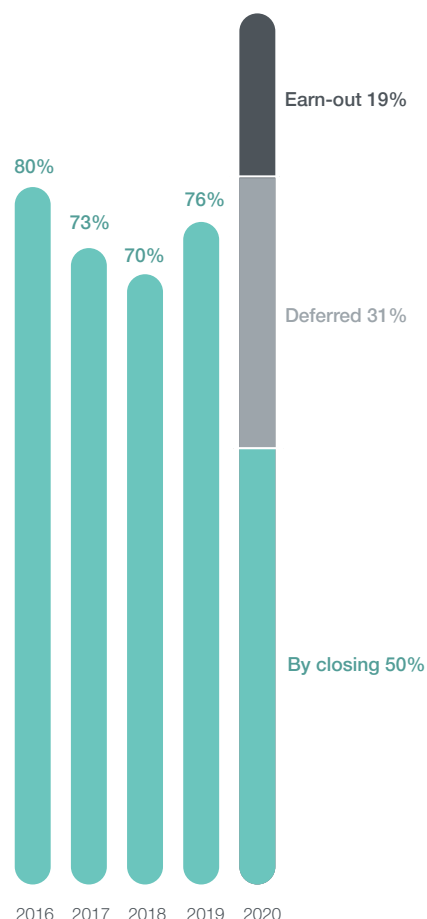
Overall a nuanced picture

There has been speculation that the short to medium-term economic changes brought about by Covid-19 might result in a shift to a fully-fledged buyer’s market for private M&A deal terms. But the picture is far more nuanced.

Buyers are focused primarily on the risk of overpaying, and are mitigating that through new pricing structures.

Sellers are keenly focused on the risk of a failed deal, and are pushing back hard on termination rights and unnecessary conditionality. They are also focused on contractual risk allocation, intent on avoiding deal value being eroded as a result of significant future liabilities under warranties and indemnities.

Timing of payment



“Buyers are focused primarily on the risk of overpaying, and are mitigating that through new pricing structures.”



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For a full briefing on our survey of global trends in private M&A during the Covid-19 pandemic, please talk to your usual A&O contact.

Foreign direct investment controls in the time of Covid-19

New measures to control foreign direct investment (**FDI**) have been unveiled around the globe during the coronavirus crisis. Is this a new wave of protectionism under the cover of Covid-19 or appropriate scrutiny in today's world?

Many governments across the world have been tightening controls on FDI – typically on national security grounds – for some years now. Countries without FDI regimes are catching up and introducing a legal framework, often as a matter of urgency.

This trend has accelerated during the coronavirus pandemic, raising concerns that we are entering a period of growing protectionism and potentially greater political interference in international M&A.

Actions and announcements, either public or rumoured in recent months, all confirm the game-changing, accelerated approach to FDI. These include:

- a move by the U.S. Senate to prohibit foreign state-controlled enterprises listing on American exchanges
- continued enforcement by the Committee on Foreign Investment in the U.S. (**CFIUS**), still the most active regime in the world
- emergency measures in Australia making all foreign takeover proposals, no matter what the value or nature of the investment, subject to up to six months' scrutiny
- Japan's move to lower the threshold for investigations into proposed foreign takeovers of listed companies

– statements by the European Commission urging all EU Member States to set up FDI review procedures and to use them to the fullest extent, when a new EU regime comes into force in October

– reports that the EU will demand mandatory notification of any acquisition where the buyer is based outside the EU and in receipt of subsidies from its home state – a significant strengthening of its position and a strategically different stance from the much lighter-touch approach reflected in the framework it set out last year

– strong indications that the long-awaited new and much more extensive control measures in the UK remain on the cards, with a Bill to introduce them expected imminently

Although not all countries explicitly single out a specific government as the key driver to increase the FDI regime, some do. Concerns around lack of symmetry or reciprocity is one key concern, while some governments have been particularly vocal on a perceived need to curtail Chinese investments in some sectors. China, itself, of course, continues to screen proposed inbound investment very vigorously.

These are unsettling developments for investors.

Impact on dealmaking during the crisis

Some of the measures that have been announced are Covid-specific, such as the new Australian regime. It has been provoked by fears that distressed companies will be taken over during a moment of extreme vulnerability, perhaps with the loss of companies considered vital to national economic or security interests.

However, the Australian government has made it clear it does not want to discourage foreign investment and there is no evidence, yet, that the regime is slowing down processes unduly.

The same is true in Japan.

Despite China's relatively strict FDI and foreign exchange regulatory control regimes, the great majority of inbound deals do get cleared by the Chinese authorities, at a time when the government in China is signalling that it wants to maintain an outward-looking and international approach to investment.

Indeed, that is the mood more widely in Asia, where many governments want the region to remain open, particularly as companies look to regionalise supply chains to make them more secure.

“The pandemic has given more and more governments a licence to intervene to a degree not seen in many decades.”

We have seen a continuing decline in cross-border transactions globally. But this predates the crisis, even if dealmaking has declined still further because of the logistical difficulties of transacting in the current environment.

China's position is seventh in the outbound acquirers' league table, which resembles the position it held some five to ten years ago, despite the sharp decline in investment into the U.S. because of the harsher CFIUS controls. However, the general reduction in activity since the boom of two years ago is as much to do with China's own controls on capital outflows as hostile FDI regimes.

Still, there are significant practical issues for investors to consider here. Strengthened regimes are adding a level of complexity to transactions, not least in competitive bid situations where a buyer with no FDI hurdles to jump through will clearly have the inside lane in any race to buy an asset.

Interventionism on an unprecedented scale

With the exception of those governments pursuing a clear protectionist agenda – of which the Trump administration is one – the strengthening of FDI regimes seems, in many cases, to be about applying appropriate scrutiny rather than out-and-out protectionism.

However, there is one noticeable change, which has been exacerbated by the Covid-19 coronavirus crisis and is likely to persist as the world hovers on the brink of what could be a deep recession.

The pandemic has given more and more governments a licence to intervene to a degree not seen in many decades.

State mechanisms to support businesses through the crisis – such as the provision of grants, loans, furlough schemes and even partial renationalisation of vulnerable companies – have risen on an unprecedented scale and will have a lasting effect.

Often governments demand a price for such support. For instance, a bailed out airline might be asked to move faster in cutting its emissions. The EU's recently published Recovery Plan has a powerful environmental flavour to it.

In that environment, governments now have a springboard for much more intervention and that can be ad hoc and unpredictable.

The impact of this will be felt more broadly than just in the realm of FDI controls.

Investors will need to get used to operating in a much more politicised and fragmented world with new regulatory challenges that can, and probably will, evolve. In this new world, there are a number of new rules to navigate. There are also new opportunities to seize. Keeping up to date with the fast-moving changes in the global market will enable investors to stay ahead of the curve and make the most of these opportunities.



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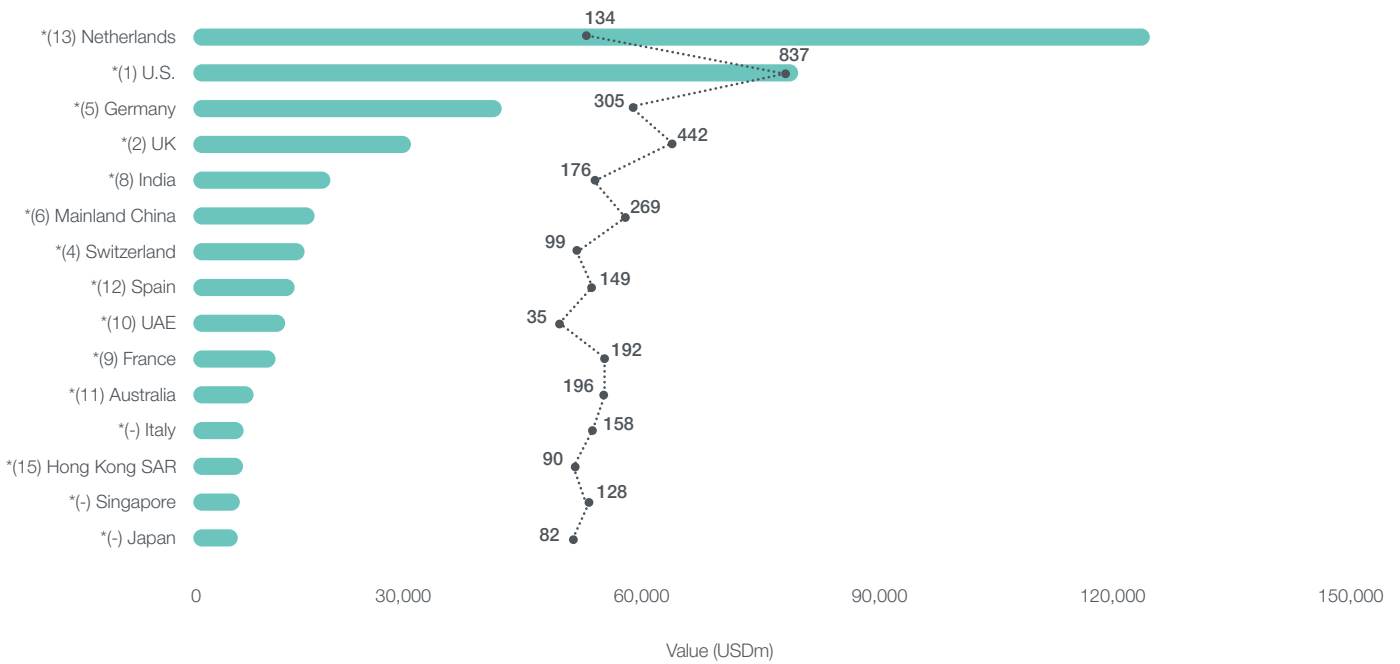
Global deal flows

● Value of deals USDm

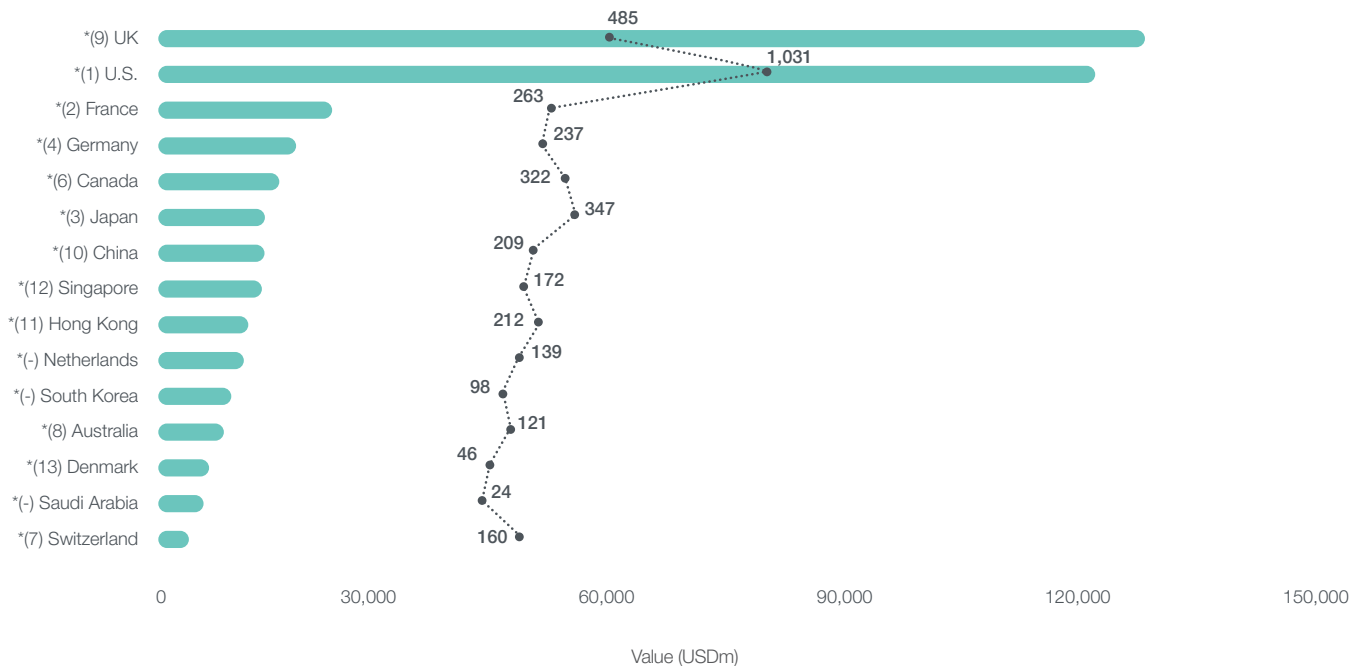
● Number of deals

*(Position by deal value in H1 2019)

Inbound target markets, H1 2020



Outbound acquirers, H1 2020



U.S. M&A: the land of opportunity meets challenges

The impact on U.S. transactions has been severe, with activity unlikely to recover until market conditions stabilise. But opportunities are emerging for certain players.

U.S. market hits the brakes

The Covid-19 pandemic has had a multitude of impacts on the U.S. M&A market, presenting challenges for parties at every stage of the deal process, including:

- valuation
- access to and the terms of financing
- conducting due diligence
- obtaining regulatory approvals and third party consents
- complying with pre-completion covenants

We have seen buyers seek to avoid completing high-profile transactions while sellers have filed suit trying to force them to do so.

High-profile deals fall through

Few industries have been immune, with both strategic and private equity players affected.

- In the technology sector, Xerox terminated its USD34bn hostile bid for HP at the end of March, having previously raised its bid.
- In cybersecurity, Advent International tried to terminate its agreement to take Forescout Technologies private.

Elsewhere the effect has been even more pronounced:

- In travel and leisure, Mirae, the Korean asset manager, is attempting to pull out of buying a portfolio of luxury hotels for USD5.8bn.
- In the fitness industry, Level 4 alleges that CorePower is using the enforced closure of its facilities as a reason to avoid purchasing a number of yoga studios.
- In retail, where lockdowns became widespread and consumer confidence dried up virtually overnight, Sycamore Partners cited numerous breaches of the purchase agreement due to store closures and employee furloughs to claim it no longer had to buy Victoria's Secret. L Brands has since let the buyer walk away.

It will take time for court cases to play out. The threshold in U.S. courts for establishing material adverse effect and the exceptions related to general economic impacts (including some specific references to pandemics) is high. So many of these cases may hinge on "ordinary course of business" covenants, which require:

- target companies to operate in the ordinary course of business between signing and closing
- that certain actions may not be taken without the buyer's consent

U.S. M&A activity, H1 2020



69%

Decrease in deal value vs. H1 2019



9%

Decrease in deal volume vs. H1 2019

29%

U.S. market share of global M&A



In addition, there are complexities. Target companies forced to shutter or significantly cut back their businesses may, arguably, not be operating in the ordinary course of business. However, they can counter claim that they are complying with other pre-completion covenants, including abiding by any laws or government directives, which drove many of their actions.

The outcome of these cases will likely depend on how courts seek to compare the conduct of each business. They may, for instance:

- use the way other businesses in the sector have acted during the pandemic as a measure
- look at how the specific business has operated historically
- take into account the length of the pandemic
- assess how quickly the business can recover
- consider whether the parties have acted and communicated in good faith

Other deals stay the course

While numerous potential deals have been shelved, we have seen agreements signed before the crisis took hold continue to completion. For example:

- Greif, Inc., a global leader in industrial packaging, completed the sale of its Consumer Packaging Group business in April
- Xperi completed its merger with TiVo
- State Grid International Development is on track to acquire Sempra Energy's Chilean business by the end of June

Notably, many of the completed transactions have involved strategic acquisitions between companies in the same sector, facing similar economic prospects.

A golden opportunity for some

Despite the widespread disruption, new opportunities are emerging for those who can deploy resources and capitalise on reduced company valuations.

For private equity firms, many armed with record amounts of cash, Private Investment in Public Equity (PIPE) transactions are on the rise. Competition here is so fierce that processes are often being run like M&A auctions, with multiple firms vying for a piece of the most desirable companies.

PIPE transactions often increase when uncertainty plagues traditional financial markets. It happened during the 2008 financial crisis, as well.

Dramatically decreased stock prices in travel, retail and entertainment companies are also providing opportunities for investors.

These deals are often in the form of an investment rather than a takeover, allowing the buyer to acquire a large stake at a discount and the target to raise cash quickly. Recent deals include Wayfair's private equity-led raising of USD535 million, and preferred stock issuances by Cheesecake Factory (USD200m) and Expedia (USD1.1bn).

“Despite the pandemic throwing many deals off course, new opportunities are emerging for those who can deploy resources to capitalise on reduced public company valuations.”

Post-pandemic landscape

Despite ongoing public health concerns, high rates of unemployment and decreased consumer confidence, equity markets have stabilised in recent weeks, largely due to massive federal government stimulus programmes.

However, M&A activity has been slower to rebound due to continued concerns about underlying economic and social conditions.

Though anecdotal evidence suggests certain players, particularly private equity, are quietly gearing up for a spurt of deal activity, a sustained and distributed recovery depends on a variety of factors. These include the stabilisation of valuations (at levels where buyers and sellers can agree), financial market conditions and, most importantly, evidence that the market is returning to growth.

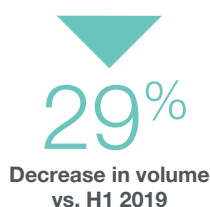




European M&A set for tough autumn

European M&A markets performed more strongly than expected in H1, buoyed by a small number of very big transactions. However, the underlying picture was far less rosy, and the short-term outlook is uncertain.

Western Europe M&A activity, H1 2020



Deal value in Western Europe rose by 30%. However, a steep 29% decline in deal volume, perhaps, provides a more accurate picture of underlying activity.

Big transactions that did complete were, generally, well advanced before the Covid-19 pandemic took hold or had to be completed for strategic reasons.

That is true of Thermo Fisher's USD11.5bn acquisition of Qiagen. Even more so for ThyssenKrupp's EUR17.2bn sale of its lift business to an investor group, led by Advent and Cinven. Without a deal, the group would be in severe financial difficulties.

The GBP31bn merger of Virgin Media and O2 in the UK reflects the continuing rapid convergence of mobile, fixed broadband and entertainment services.

Placing a value on the alliance was made easier since it was free of any cash element. More widely, valuing assets has become difficult given the uncertain economic outlook.

Safety first for investors

The pandemic has forced nervous investors to take a "safety first" approach and has left businesses focused primarily on conserving cash rather than M&A.

Deals are getting done. With share prices recovering, potential public deals are under review. Well-funded private equity houses also continue to assess significant "take-private" deals, when prices stabilise.

Targets with business plans that remain viable are still attracting attention, notably in the healthcare and technology sectors.

More fragile sectors – such as aviation, leisure, hotels, travel and automotive supply – are off the radar. However, we could see consolidation and distressed deals, and, in some cases, government intervention in these areas.

An uncertain outlook

It will take time for M&A activity to revive and Q3 is likely to be a tough one, with investor confidence remaining subdued.

That is even more likely with major political uncertainty hanging over future trading plans and the need to reconfigure supply chains.

Most businesses are now banking on a hard Brexit, given the lack of progress in the EU/UK trade talks as the end-of-year deadline looms. This will prolong uncertainty.

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China maintains outward-looking approach

The Covid-19 crisis has slowed Chinese deal activity. Activity remains sluggish even though the country is emerging from the crisis earlier than the rest of the world.

- While deal value for China was stable in H1, with a 0% change, volume fell 13%.
- The picture was worse for outbound deals, with value and volume down by 26% and 25%, respectively.

Despite tougher controls on FDI in many countries, it is expected that China will continue, as part of its ongoing strategy, its international and outward-looking approach to outbound and inbound M&A.

With the economy shrinking for the first time in decades (GDP fell by 6.8% in Q1), strategic M&A transactions will play an important part in the recovery.

That seemed to be the message from May's National People's Congress, where the government did not publish a target for GDP growth.

In part, that reflects deep uncertainty about how quickly the Chinese domestic economy can return to normal and where the global economy is going. It also indicates that China wants to avoid the often speculative investment boom following the financial crisis.

Support for strategic outbound deals

China is likely to back sensible outbound investments in key jurisdictions and sectors, not least as part of the ongoing Belt and Road initiative. China will be much more careful in how it describes its engagement with both the developing and developed world.

Deals in strategic sectors designed to upscale and bring new technologies to Chinese industries are expected to continue, such as those targeting:

- Technologies
- Renewable energy
- Infrastructure
- Advanced manufacturing technologies
- Biotech and healthcare

The need to raise additional capital could also see a growth in international fundraising; for instance through cross-border listings. One example is the Shanghai-London Stock Connect programme.

But outbound investors face a range of hurdles, alongside tougher FDI controls that have been erected by other countries.

Increased competition for assets, particularly from nimble and well-funded private equity funds, will require buyers to be more flexible over pricing and deal terms.

As the bitter trade standoff with the U.S. continues – exemplified by the battle over Huawei's involvement in western 5G networks – Chinese buyers also face the task of building trust in overseas markets.

Open to inbound investors

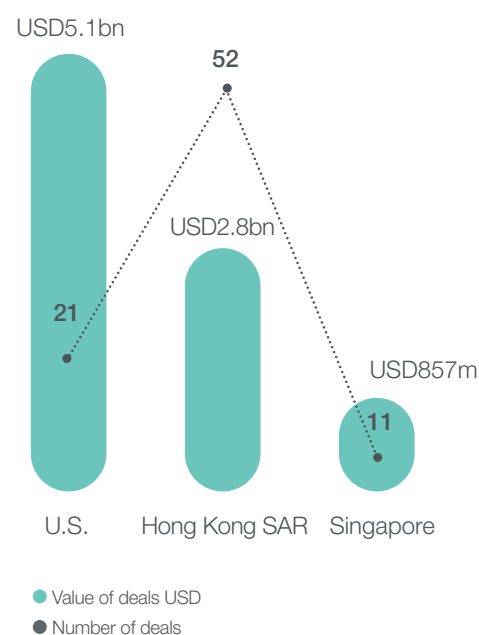
China continues to ease restrictions on inbound investment.

Regulations governing the pharmaceutical sector, for instance, have been modernised and we are seeing strong activity here. The clean energy and infrastructure sectors also remain active.

Multinational companies that no longer see China as a cost-effective base are making an exit, in a trend accelerated by the crisis.

However, those wanting a stronger presence in China are finding it an increasingly investor-friendly market.

China top three target markets (H1 2020)



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