ALLEN & OVERY

M&A Insights

H1 2021

New challenges, new opportunities

allenovery.com

Contents

This PDF includes elements of interactivity throughout

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

Transaction value soars across deal types and regions

While transaction data for the first half of 2021 show an extraordinarily strong year-on-year growth in worldwide deal value, they do compare with the quietest period for transactions in a decade as Covid-19 took hold last spring.

Nevertheless, with worldwide H1 transaction value up 131%, the figures still clearly indicate that the recovery in global M&A deals, which began in the second half of 2020, is continuing apace, even if deal volume was up by a more modest 29%.

Similar increases are being seen in the value of public target transactions, cross-border, and domestic deals.

Regionally we are seeing a consistent growth across the world, with the exception of Eastern Europe. The U.S. has rebounded strongly, with deal value growing 249%, while APAC (including Japan), Western Europe and Greater China have seen the value of deals rise by 75%, 52% and 53% respectively. The fastest growth has been seen in Latin America and Sub-Saharan Africa, although the latter is from a low base.

SPAC formation fever cools

One counter-trend is the sudden and sharp Q2 slowdown in the formation of U.S. Special Purpose Acquisition Companies (SPACs), after 15 months of explosive growth.

As we discuss in detail in this report, it's important to distinguish between SPAC formations, and the increasingly urgent efforts by the many SPACs, already created, to find appropriate targets to acquire and take public.

As they look to deploy huge amounts of raised capital, they will continue to be a major driving force of M&A activity in the months ahead.

Outlook

There is every prospect that M&A markets will remain strong as the world edges back towards some kind of normality.

However, the course of the pandemic remains uncertain, and the prospect of higher interest rates is growing. Both could slow the market, as the year progresses.

131%
Increase in global deal value
H1 2021 vs H1 2020

29%
Increase in global deal volume
H1 2021 vs H1 2020

Value rises across the board
Megadeals have returned strongly:

Deals over USD5 billion

% of total M&A in H1

37%

Value: 131%

Volume: 169%

Deals over USD10 billion

% of total M&A in H1

20%

Value: 82%

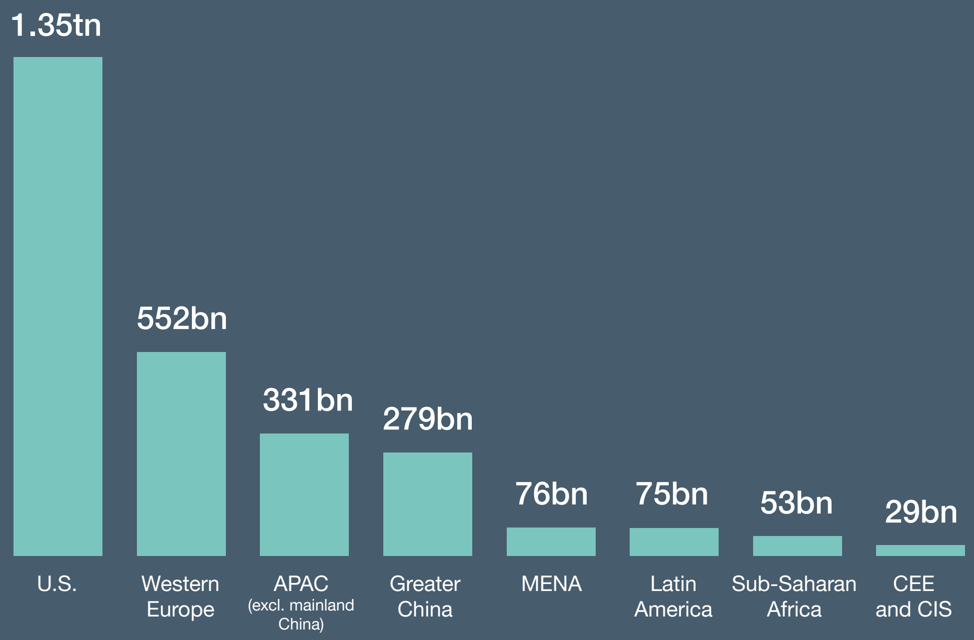
Volume: 108%

Note: Figures represent deals announced between 1 January and 30 June 2021.

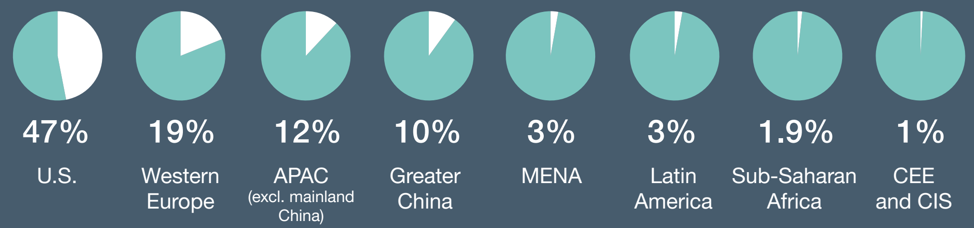
Data provided by REFINITIV

Global M&A H1 2021 snapshot

Split of global M&A deals by value (USD)



% split of total



% change from H1 2020

▲ 249%
U.S.

▲ 52%
Western Europe

▲ 103%
APAC (excl. mainland China)

▲ 53%
Greater China

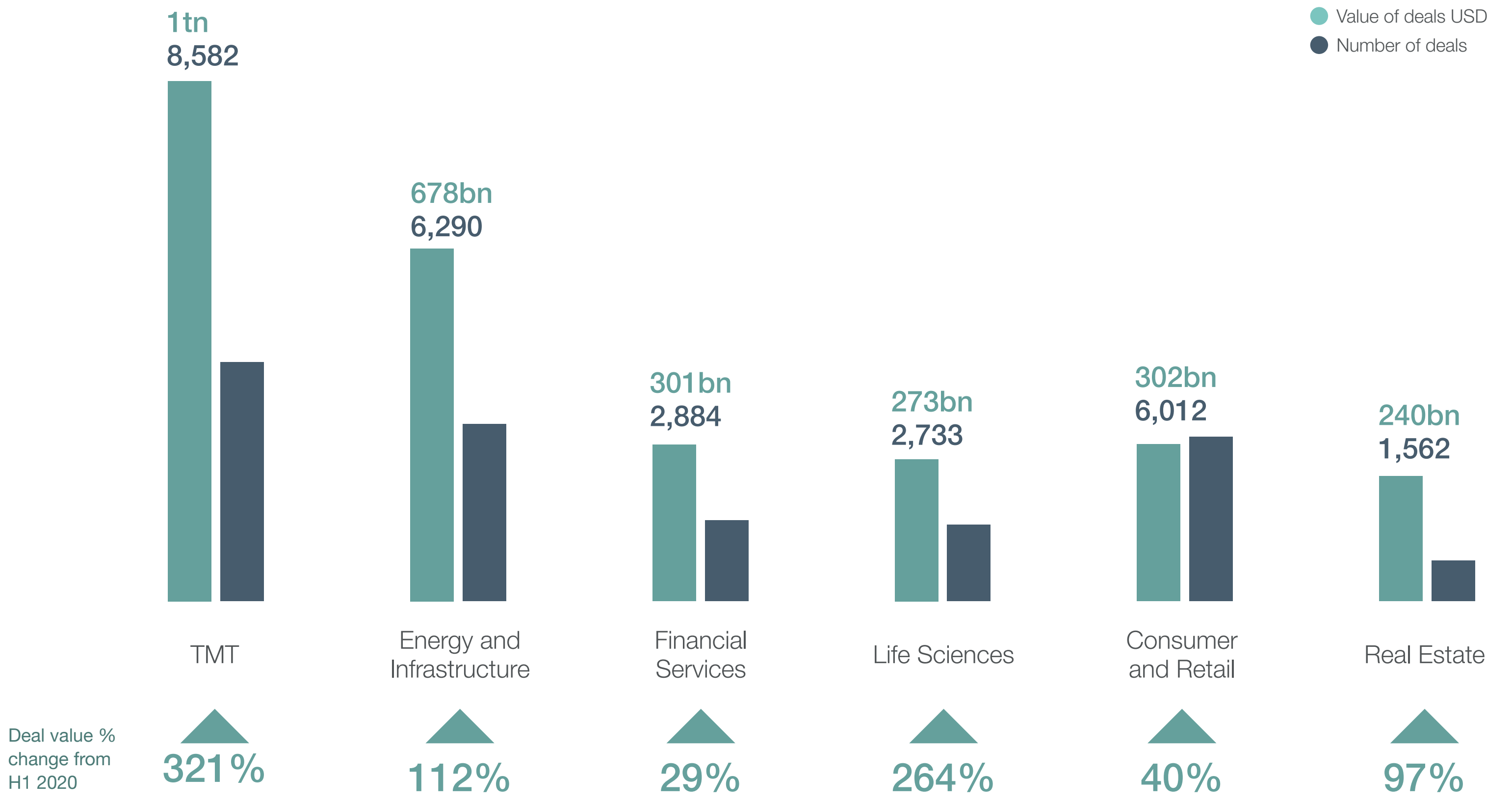
▲ 67%
MENA

▲ 551%
Latin America

▲ 948%
Sub-Saharan Africa

▼ 48%
CEE and CIS

Global M&A by sector, H1 2021



A rise in hydrogen-related M&A activity globally

As international pressure mounts for urgent responses to climate change, there are signs that, after several false dawns, hydrogen is finally emerging as a key component in the transition from fossil fuels.

The pressure for de-carbonisation is driven by the Paris Climate Agreement and UN Sustainable Development goals, implemented through regulatory reform and increasingly (as evidenced in recent weeks), even the courts.

Public opinion and activist shareholders represent a parallel development that also reflects a clear generational shift in priorities and values.

The many potential applications for hydrogen – from acting as a substitute for natural gas/ LNG, to use in transportation and mobility, through to blending for domestic and industrial uses – have long been known.

Indeed, thanks to its flexibility, one leading renewables company calls it the "Swiss army knife" of energy.

But it is only now that we are seeing the momentum gathering behind hydrogen.

Technology drives change in acceptance of hydrogen as an energy source

Technological advances are also driving growing acceptance of hydrogen as an energy source, and interest in hydrogen technologies is prompting hydrogen-related M&A activity globally.

These include advances in:

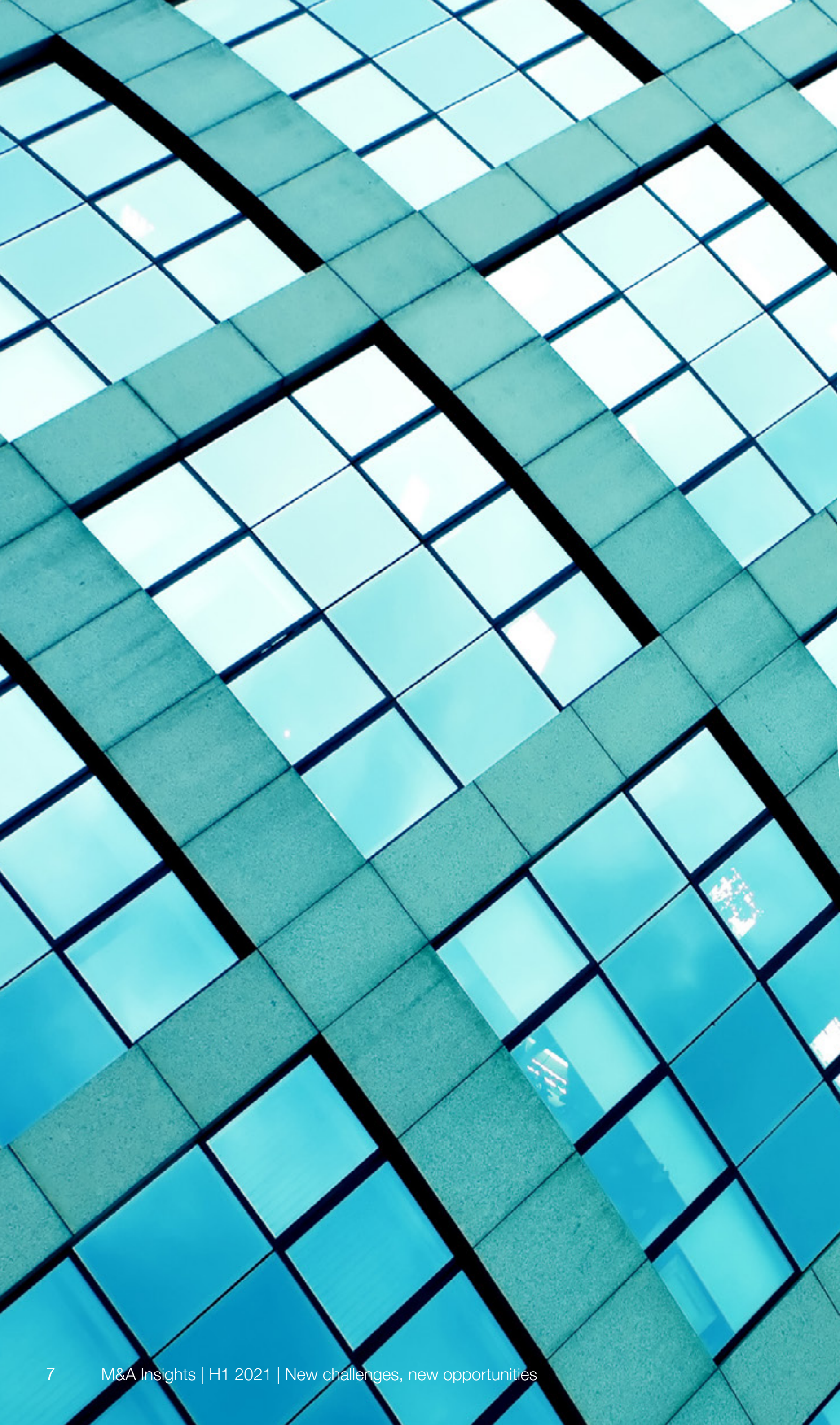
- **electrolyser technology, particularly with efficiencies conducive to the production of "green" hydrogen, which is emerging as the "holy grail" of hydrogen alternatives (in preference to more carbon-intensive "brown" and "blue" hydrogen varieties)**
- **fuel cells for use in transport and mobility, with particular interest in heavy and long-haul applications that have traditionally relied on diesel fuel (such as long-haulage trains, trucks and mining machinery)**

While we expect to continue to see brown and blue hydrogen projects develop (especially where carbon capture and storage is included), it is outpaced by the interest in green hydrogen over the past 18 months.

That in part reflects government action to incentivise green hydrogen projects through a variety of grants and funding schemes.

In Australia, for example, the Murray Valley blended hydrogen joint venture between Engie and the Australian Gas Infrastructure Group is one of several projects to win a multi-million package of government funding for qualifying green hydrogen developments.

In line with this, the market is now seeing the start of significant investment in integrated green hydrogen projects such as the ambitious green hydrogen-for-export 'Asian Renewable Hub' in Western Australia's Pilbara. Investment in such developments will be a focal point in Australia and the Middle East especially, where governments look to transition from being major exporters of LNG to leading exporters of hydrogen.



Joint ventures dominate the hydrogen M&A market

The M&A activity we are seeing through Allen & Overy's Hydrogen Interest Group, comprising some 150 lawyers from across our global network, is so far focused largely on joint ventures and collaboration arrangements. These tend to be either around project joint-development or technology development or investment.

We are also seeing a focus on investments, or buy-outs, of smaller players that control the IP rights to new and emerging technologies.

Amongst the growing number of technology joint ventures that we are seeing in the market are:

– **a joint venture between Toyota and five Chinese automotive firms to develop hydrogen fuel cells for commercial vehicles**

– **a 50/50 fuel cell venture between Daimler and Volvo**

– **Hyundai and H2 Energy combining to develop green hydrogen trucks for rental to commercial customers in Europe**

– **Weichai Power taking a stake in Canada's Ballard as part of a project to develop fuel cell systems for buses, trucks and forklifts for the Chinese market**

We are also seeing a sharp increase in production projects bringing international partners together to produce both blue and green hydrogen in places as diverse as Singapore, Saudi Arabia, the UK, France, Denmark and Spain.

Increasingly clients in the APAC region are examining export and investment opportunities in Europe. Consistent with how they have traditionally invested in energy and resources projects, we expect that where Japanese, South Korean and Chinese investors are planning significant off-take of hydrogen, they will likely seek an equity stake in the related project.

Transactions look set to accelerate as the challenges of climate change become increasingly apparent.

Listen to Goran Galic on the growing number of joint ventures in green hydrogen.

09:49

Download podcast

Available to listen on:

Apple Podcasts | Podbean | Spotify | Stitcher | Google Podcasts

Innovation and search for growth spark MedTech rebound

The postponement of non-urgent medical procedures in the early days of the Covid-19 pandemic led to a lull in MedTech transaction activity in the first half of 2020 but makers of medical devices returned in force in the second half of the year. 2021 has seen transactions continue to surge.

Q1 was the busiest quarter for MedTech M&A since 2016, with as many as ten deals announced in the first six weeks of the year alone, valued at some USD10bn.

Two distinct trends are evident:

- **those players whose products have been in high demand during the pandemic have seen revenues grow strongly and are now eager to put strengthened balance sheets and cash reserves to work**
- **those who experienced a dip in demand are now looking for opportunities to invest in targets that offer them the chance to return to high growth**

Consolidation

Although we are seeing some substantial deals, megadeals remain rare and the accent continues to be on a higher number of smaller deals.

This trend is likely to continue as the market stabilises following the crisis, particularly where small and medium sized players are concerned.

Private equity (PE) players, with record levels of dry powder, are active in the sector, particularly those looking to pursue buy and build strategies. For example, there is the recently proposed USD30bn acquisition of medical supply maker and distributor Medline by a group of private equity firms, including Blackstone, Carlyle and Hellman & Friedman, or Permira's bid to acquire LivaNova, a MedTech company active in the fields of cardiac surgery and neuromodulation.

Innovation is driving deals

Innovation is another driver of deals. Boston Scientific, which acquired both surgical laser group, Lumenis, and the cardiac monitoring business, Preventice, in Q1 to boost its portfolio of innovative products, stands out as a company pursuing a "try before you buy" strategy, often making minority investments in targets ahead of a full acquisition.

Digital health remains a hot segment of the market, where increased M&A activity is likely, particularly as the growth of virtual clinical trials drives demand for digital gadgets and know-how.

Activity in diagnostics has also partly been driven by the pandemic and we have seen substantial deals here, including the DiaSorin/Luminex and Roche/GenMark transactions, both valued at USD1.8bn, and Hologic's EUR668 million acquisition of Mobidiag.

Higher regulatory hurdles

Regulation can be a constraint on M&A activity.

Illumina's long struggle to gain clearance in Europe and the U.S. to bring the Grail cancer testing business it hived off in 2016 back within the group shows that antitrust authorities are taking a tough stance where MedTech is concerned.

Siemens Healthineers has also been forced to accept a range of testing remedies by the EU to get clearance for its acquisition of Varian, the radiation oncology and software business.

As many governments tighten their controls on foreign direct investment (FDI) on national security and public interest grounds, we expect to see deals involving important medical infrastructure and technology subjected to increased scrutiny, in the UK, Germany, France, Italy and the U.S., amongst others.

However, the burden of regulation can also drive consolidation. For example, the investment required to introduce transformative technologies such as Artificial Intelligence into the business may drive combinations and partnerships, just as the new European medical device regulation regime may also prompt smaller players to combine to cope with regulatory requirements.

Dramatic pause in global SPACs clouds outlook

The extraordinary boom in U.S. SPAC formations continued in Q1 but declined steeply from April onwards. Few believe the trend is over, but a period of greater uncertainty seems likely. SPACs are now making their presence felt in both Europe and Asia, although not at the pace seen in the U.S.

As 2021 began, it looked certain that the boom in the formation of SPACs, particularly in the U.S., was set to continue on the extraordinary trajectory seen last year.

Indeed, Q1 saw 310 SPACs formed globally, raising USD95.5bn through SPAC IPOs.

But that activity went into steep decline in Q2, with just 76 SPAC IPOs globally raising a total of just USD14.6bn.

Global SPAC IPO activity, H1 2021

Number of issues:

Q1	Q2
310	76

Proceeds raised:

Q1	Q2
USD 95.5bn	USD 14.6bn

Inevitably, that led sceptical market commentators to wonder whether the SPAC boom had turned to bust or, more likely, whether SPAC transactions were simply heading for greater uncertainty after a period of explosive growth.

SPACs are not a new phenomenon. They first emerged in the 1990s. But they have ballooned in the last 18 months, particularly in the U.S., where over 90% of SPAC activity is concentrated.

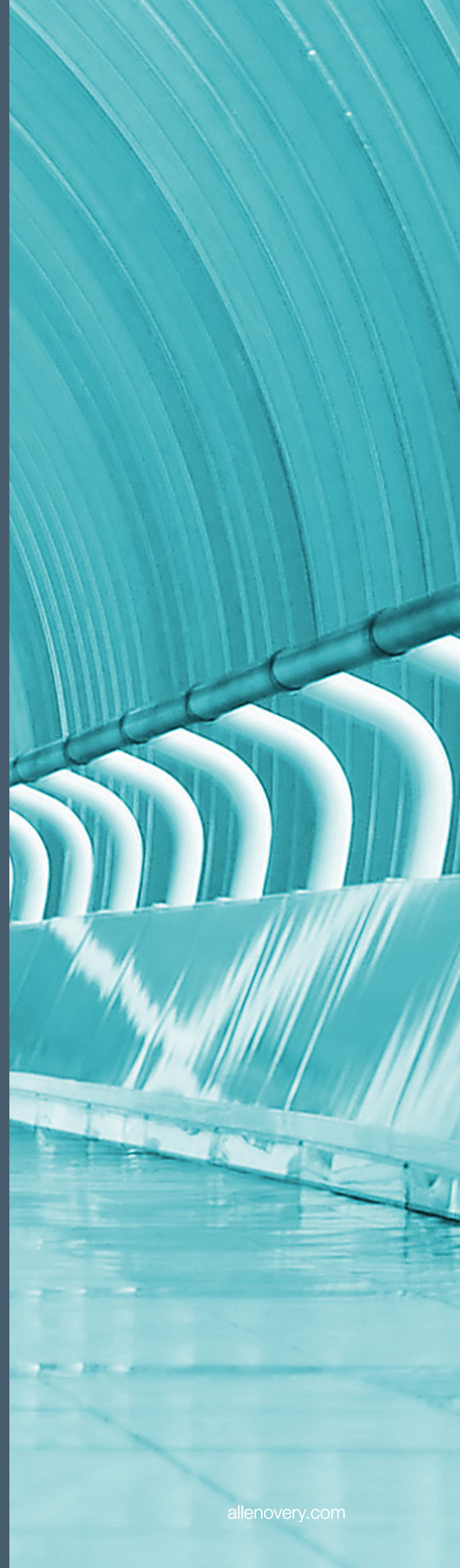
They provide an alternative route to the traditional IPO for private companies to seek a public listing, and, under the right market conditions, offer rich returns for sponsors and investors alike.

SPACs, also known as blank cheque companies, raise finance through an IPO with the intention of later finding an appropriate target to acquire within a limited timeframe, usually 24 months.

The target is not identified at the time of the IPO, although sponsors may well have the expertise, and may express an intention, to target specific markets and sectors.

Once a target has been identified and acquired, it is merged with the SPAC and takes on its public listing – a process called the de-SPAC. Often at this stage a proportion of initial investors will pull out, their place being taken by so-called PIPE – private investment in public equity – investors with the PIPEs providing a form of validation for the value put on the target company, and allowing the SPAC to acquire a larger target than could be bought with the IPO funds alone.

It's important to note that while SPAC IPOs have gone into a period of decline, the process of de-SPACing is continuing apace, as SPACs aggressively seek targets to acquire.



Why the decline in U.S. SPAC IPOs?

There are three main reasons why we have seen a sharp fall off in SPAC IPOs in the U.S.:

- **a general cooling of equity markets, coupled with specific concerns that technology and other high multiple, high growth businesses, the favoured targets of SPACs, may be vulnerable to rising interest rates as inflation picks up**
- **mixed performance of SPACs, with some declining in value after the de-SPAC has taken place**
- **indications from the Securities and Exchange Commission (SEC) on 12 April that most SPAC warrants, issued to SPAC sponsors, should be reclassified as liabilities, possibly forcing a restatement of SPAC financials. The SEC's new chairman has since suggested that regulations could be introduced to improve the transparency of SPAC disclosures**

Few believe that the SEC's intervention signals the arrival of a hostile regulatory environment for SPACs. But it is clear that Biden administration appointees are intent on keeping a much closer watch on SPACs than was the case under President Trump.

We expect regulation to focus on making sure investors are given sufficient information to understand the risks involved in SPAC structures. In particular, it is likely to tackle the required disclosure relating to the degree to which the sponsor's promotion – a feature allowing the sponsor to retain up to 20% of the IPO share capital at the point of de-SPACing, along with any warrants it holds – can dilute investor returns substantially.

An overcrowded market

The more immediate risk lies in the fact that there are currently too many SPACs chasing a relative shortage of attractive targets.

The relatively slow pace of de-SPAC transactions means that already stiff competition to identify appropriate targets in an overcrowded market will only intensify.

Sponsors will be loath to have to pay back investors if they fail to find targets in the allotted time, so we expect them to be highly aggressive in their search, including looking to new markets, in Europe and Asia, for possible acquisitions.

In doing so, they are most likely to continue targeting high growth sectors, including technology, fintech, healthcare and renewable energy. Already we are seeing U.S. SPACs competing for prized assets in Europe and making acquisitions in Asia.

> "Operating companies in traditional sectors, including **industrial agriculture, are taking calls from U.S. SPACs**, underlining how wide and how deep the search for appropriate targets has become."

A growing trend in Europe and Asia

SPACs are now making their presence felt in both Europe and Asia, although they have not grown at anything like the pace we have seen in the U.S.

In Europe, Amsterdam set the pace for SPAC formation and we were involved in launching the first four in this market.

These early transactions have set the pace for further growth, with the AFM, the Dutch regulator, and Euronext Amsterdam, the Dutch stock exchange, accommodating SPAC formation repeatedly to fit local requirements. With the precedents set, the expectation is that the Amsterdam exchange may see a further 10 to 15 SPACs formed over the summer, representing a fraction of the wider European IPO market and easily absorbable by the market.

Luxembourg has established itself as a centre for completing the regulatory documentation for SPAC IPOs, such that the SPACs that have been created there have been "passported" under EU regulations and are listed on the Frankfurt exchange.

Italy has a well developed SPAC model, but it is aimed at the domestic market and differs from the international model. Meanwhile, the UK has talked of amending its listing requirements to allow for SPAC formations, although there is growing concern that the London market may have missed the boat.

There are increasing signs of SPAC activity in the Asia Pacific region, with most of the recent activity focused on de-SPAC transactions. This includes the world's biggest SPAC acquisition, which saw Grab, the Singapore-based rideshare, food delivery and online banking Super App, going public in a merger with the Altimeter Growth Corporation, valued at USD40bn.

SPAC interest centres on the high number of Unicorn tech companies, valued at over USD1bn in the region, particularly in Indonesia. Here, two leading players, the GoJek rideshare and financial services group and Tokopedia, the e-commerce retailer, have merged to form the GoTo Group. The combined group intends to seek a dual listing later this year, although to do so may require reforms of Indonesian capital market and listing rules.

We have seen a few tech-specific SPACs formed to target the region, and regulators in Singapore, Hong Kong and Jakarta have mooted the possibility of creating SPAC regimes for domestic companies.

Asia is a prime destination for SPACs given the slew of possible de-SPAC targets that operate in the region, which benefit from Asia's growth trajectory. Singapore, for instance, has issued its highly anticipated draft rules on SPACs. The industry has shown keen interest, with many hoping final rules will be implemented by autumn, and a successful listing occurring soon thereafter. A successful SPAC listing in Asia will undoubtedly be a catalyst for more SPAC listings across the region.

Questions for target companies

For target companies there are clear pros and cons to pursuing a SPAC deal as opposed to taking the conventional IPO route.

A SPAC amalgamation may simplify the process of achieving a listing, particularly the lengthy process of preparing prospectuses. But it will not necessarily be quicker or less costly, particularly if the eventual valuation achieved is more disappointing than hoped for.

Traditional IPOs may take up to nine months to prepare. The success of the listing will be dependent on market conditions on the days surrounding that distant listing date, and many listings get abandoned at the last minute due to poor market conditions. SPAC transactions provide a greater degree of certainty in that regard.

Targets do have the flexibility of waiting to decide which route to pursue, keeping both the IPO and SPAC options open. For example, one of the first SPACs on the Amsterdam market completed a de-SPAC transaction in February 2020, a couple of months after the target had been forced to abandon a previously planned IPO.

Aiming for a listing on the U.S. capital markets, the most liquid in the world, has obvious attractions for potential targets based elsewhere in the world. But there are potential downsides too, not least being propelled into a heavily regulated market with tough reporting and governance rules to be met. It won't suit all businesses and those determined to attract U.S. investors can still do so through other exchanges.

Whatever the route chosen, it is vital that in the run up to either an IPO or a SPAC transaction, target companies devote proper time and resources to preparing themselves for the considerable rigours of life as a listed company. In particular it is vital to make sure that financial reporting and management information systems are up to scratch.

Will the uncertainty persist?

The outlook for SPAC formation has undoubtedly become more clouded, and activity is likely to remain closely linked to equity market conditions, ebbing and flowing accordingly.

Though some regulators are clearly pleased to see some of the heat being taken out of the market, the overall regulatory environment in key jurisdictions remains favourable for SPAC transactions.

SPACs are not going to disappear, but neither are they going to replace the traditional IPO as a route to public listing. Instead they are likely to remain an important item in the corporate finance toolkit, and will be particularly relevant to companies, such as technology targets, with a high growth story, as we discuss in more detail later in this **report**.

SPACs will, however, need to confront some key challenges to retain their relevance.

They will need to address the dilution effect caused by the sponsor's promote or carried interest.

The effect of this has been disguised in the past both by large PIPE investments at the point of the de-SPAC transaction and by the strength, until recently, of equity markets. In more uncertain times, sponsors will have to work harder to create value for investors to justify their promote.

A more fundamental issue is the fact that a high proportion of investors exit at the time of the de-SPAC to be replaced by PIPE or other financing. Sceptics could argue that these initial investors, far from being blind pool investors looking for a target to acquire, are merely keeping the seat warm in return for the warrant they are allowed to keep after exiting.

If regulators decide this is indeed what is happening, there is a chance they could push for rule changes that would limit the ability of the de-SPAC company to inherit the original SPAC's registration and listing.

Issues such as these suggest that the current uncertainty is likely to persist for some time.

Tech companies and SPACs see interests align

As SPACs continue their urgent search for appropriate companies to acquire and take public, high growth technology companies are amongst the most sought after targets.

Research suggests that tech businesses are the preferred target for a large number of SPACs that have declared which sectors they are looking to invest in. The research also indicates that the TMT sector accounts for considerably more than other sectors (30% of SPAC investment).

And the attraction goes both ways, it seems. Why is this?

A viable alternative to IPO

SPACs offer young and fast-growing tech businesses seeking a listing an alternative to the traditional IPO.

Many will not have the credentials of a traditional IPO candidate, possibly being unable to deliver the kind of long-term financial and operating track record traditionally expected of a successful IPO.

They may be in the very early stages of development, looking for ways to finance the research and development programmes that their future success depends on, and are certainly likely to be pre-profit and in some cases pre-revenue (again unusual on a traditional IPO).

For example, a number of untested electric vehicle companies, including Nikola, Fisker, Lordstown and Canoo, "SPACed" on to the public market in the last year and have yet to generate meaningful revenue.

Disruptive companies tend to have an affinity for disruptive processes, and many tech groups see SPACs as a disruptive force in the IPO market.

They also tend to view the traditional IPO process as cumbersome, time-consuming and expensive, although the evidence suggests that the cost of joining forces with a SPAC can be just as high, unless offset by achieving a high multiple on listing.

Negotiating with a SPAC on price also holds an appeal for venture capital firms looking to offload a business they have supported through early financing. There is far greater uncertainty in pursuing an IPO, where the value achieved will depend heavily on the state of the equity markets on and around listing day.

Too many SPACs, too few targets

The extraordinary proliferation of U.S. SPAC formations in the last 18 months means that there is now intense competition to find appropriate targets within the lifetime of the process, usually 24 months.

That competition will remain fierce even though we have seen a lull in SPAC formations in Q2 2021, as comparatively few of those already formed have completed a de-SPAC acquisition.

Increasingly we are seeing SPACs look offshore in continental Europe, the UK and Asia for assets to buy. One SPAC, Kyte, has been set up exclusively to target tech companies in Israel, which has an abundance of tech unicorn companies.

Research suggests that around 18 U.S. SPACs are specifically mandated to look for a target in Europe and this number may well grow as competition intensifies. Already, we are seeing U.S. SPAC investors appearing in competitive European auction processes.

SPAC transaction complexities

However, gaining a New York listing, with all the regulatory and tax implications that come with it, will not be the right route for all companies.

SPAC transactions are inherently complex and once underway can move at incredibly high speed. That can be very uncomfortable if the target company does not have the right processes in place.

It is unlikely that SPACs will replace the traditional IPO, although we could see the traditional IPO process being reformed to compete more effectively with SPACs.

Instead we believe SPACs will remain just one of a number of items in the corporate finance tool kit for companies (tech or otherwise) aiming one day to achieve a listing.

> "Increasingly we are seeing SPACs look offshore in continental Europe, the UK and Asia for assets to buy."

Changed work culture raises M&A challenges

The Covid-19 pandemic has, arguably, done more to change the culture of work than any other event in recent history, presenting all businesses but particularly those looking to restructure or those contemplating acquisitions, with a new set of legal and organisational challenges.

The immediate priority for many employers is to decide what work should look like when the world emerges into the new post-Covid reality.

For many of our clients that means embracing hybrid work patterns, with a mixture of remote and office working, and some considering mandatory Covid-19 testing for employees when they do return to the workplace. However, most appear to have rejected the idea of mandatory vaccination given the legal challenges this approach presents both in terms of privacy and employment constraints in some jurisdictions.

It remains to be seen how many employers will take the opportunity of revised work patterns to push through deeper restructuring programmes and reduce their workforces.

Here the impact of the crisis has yet to be fully felt in many jurisdictions.

Covid-19 impact affected by government support in some countries

Initially, the consensus was that we would see an upsurge in redundancies and a raft of distressed M&A deals as the pandemic first took hold in early 2020.

But unprecedented levels of government support for companies and for employees, through furlough and short-time working schemes, have meant that much of this activity has been postponed and may not take effect until those schemes are progressively withdrawn.

The impact has varied from sector to sector. For example:

- **airlines quickly shed tens of thousands of jobs as international travel grounded to a halt**
- **the auto industry is one of a number of, perhaps surprising, industries that have seen profit margins soar during the pandemic**
- **in some jurisdictions, such as the U.S. and UK, key sectors such as hospitality are actually struggling to recruit the staff they need to fully reopen**

In Greater China, businesses have not received the same levels of direct financial support and we have seen a number of companies push through restructuring and focus on refreshing management teams to try to stimulate new growth.

Changes to the employment landscape

It seems likely that it is only a matter of time before we do see restructuring activity in many jurisdictions and an upsurge in distressed takeover deals. At that point, employers and acquirers will find that Covid-19 has changed the employment landscape in subtle but important ways.

Germany, for example, introduced two key measures to support businesses through the crisis:

Lifting some of the legal obligations for companies to declare themselves insolvent due to indebtedness

Offering employers financial support to put staff on paid short-time working with up to 67% of their net wages met by the state

Both schemes are likely to have some drastic effects as they are removed.

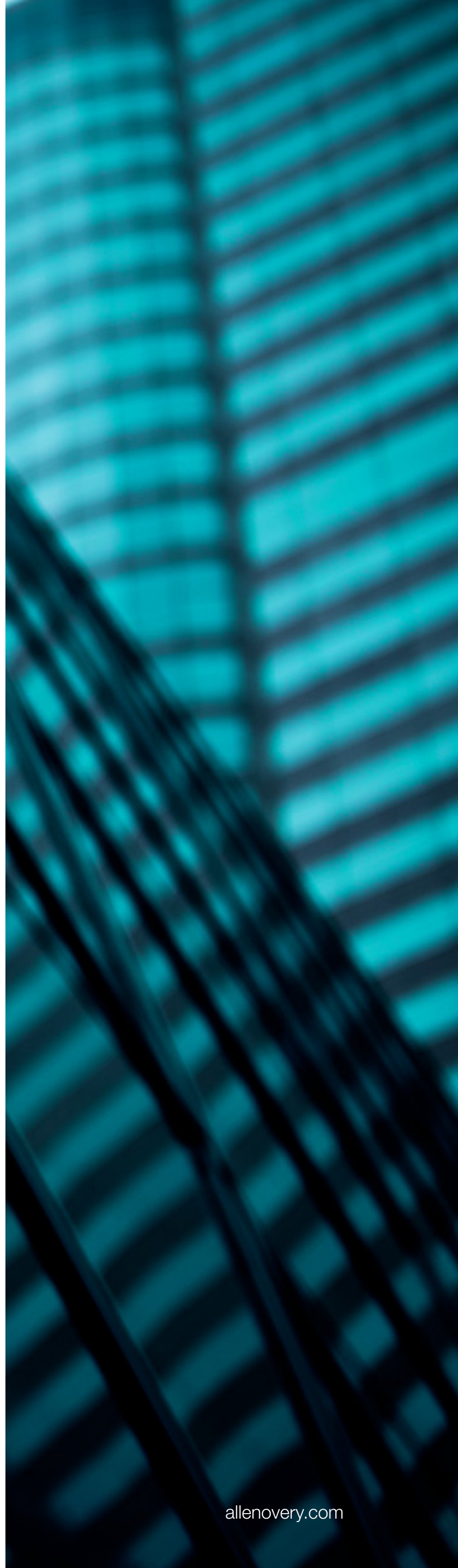
For instance, there is growing concern that insolvent businesses will be unable to pay other companies they have continued to trade with, leaving many otherwise viable businesses vulnerable to financial difficulty and even failure.

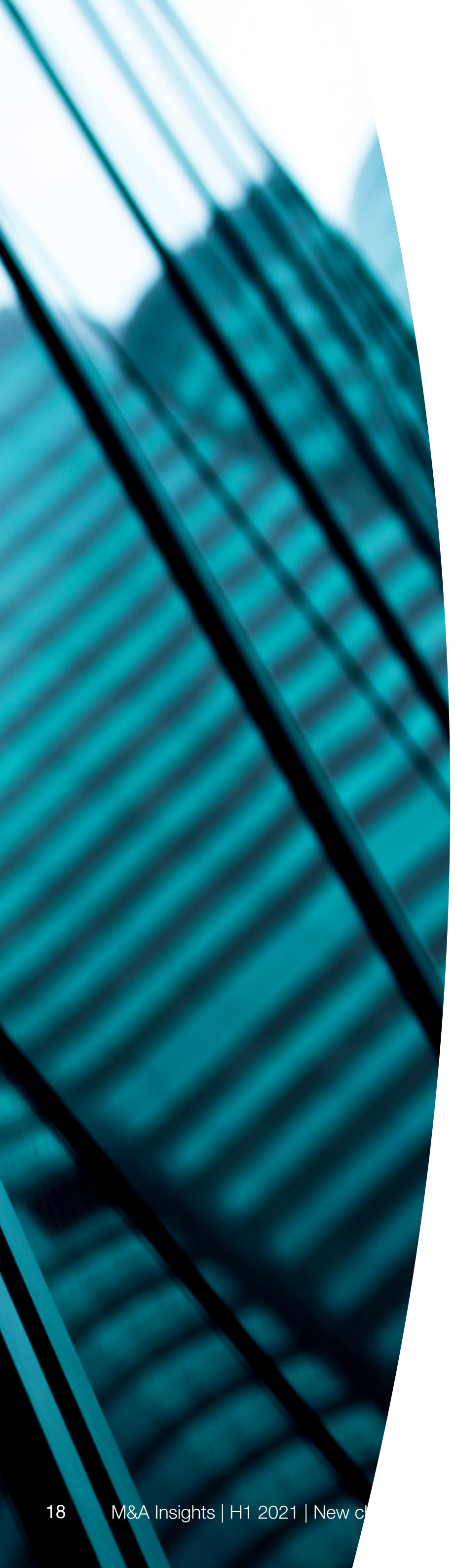
Similarly, businesses that have taken advantage of the short-time working scheme without the necessary consultation with works councils or the appropriate contract cover, may find themselves liable to repay government financial support.

Interestingly, we are also seeing some employers where no works council had been established before, being confronted with works council elections. At the same time employees are becoming increasingly interested in joining a labour union, since the overall perception that strong employee representation can help employees in times of change and crisis has significantly increased.

There have been no new legal provisions in the UK to cover M&A deals, where employment rights are still governed by TUPE, the transfer of undertakings regulation. This EU regulation continues to apply post-Brexit and includes specific provisions for distressed takeovers.

However, balancing the need for company administrators to agree a sale and maintaining confidentiality, while meeting obligations under TUPE to consult with employees in a reasonable timeframe, remains as complex as ever.





Common themes emerging globally

These are not common concerns for employers and acquirers in the U.S., where union representation in the private sector is declining and much of employment law is driven by the employment contract.

However, a number of trends are emerging across many jurisdictions.

For example, the adoption of representations and warranties insurance in M&A transactions is growing in the U.S. and Germany, with employment issues writ large in such provisions and affecting both buyers and sellers.

The distinction between full-time employees and contractors hired on a freelance basis continues to be an issue in many jurisdictions, particularly around the issue of so-called "disguised employees" who, despite being contractors, are, in reality, working on a full-time basis.

Although this is a concern that pre-dates the pandemic, Covid-19 has exacerbated the issue and is likely to continue to do so as employees continue to work remotely and more flexibly. Where, for instance, does the employer's liability for tax and social security payments lie when an employee opts to work in a different jurisdiction?

In the U.S., the issue is further complicated by the fact that some states and cities levy income tax, while others don't. An employee could, for instance, work for a company based in New York, which does levy tax, but choose to work remotely from Florida, which does not.

Cultural issues and employee activism playing a part in transactions

More significantly we are seeing cultural issues, particularly around gender and race representation as well as workplace culture, play a much bigger part in transactions and in the calculations of buyers.

Acquirers are now likely to put a far greater emphasis on such concerns as part of the due diligence process than ever before as they seek to unearth whether the target company has outstanding #metoo or broader discrimination or bullying issues. We have even see buyers walk away from deals where such concerns have been brought to light.

Although this is a particular feature in key sectors, notably the media, film and TV, it is very likely to become more prevalent in other sectors.

Employee activism is another common theme across jurisdictions, with employees increasingly coming together, often through social media platforms, to advocate for change within their company on key cultural issues such as climate change, social justice and equality.

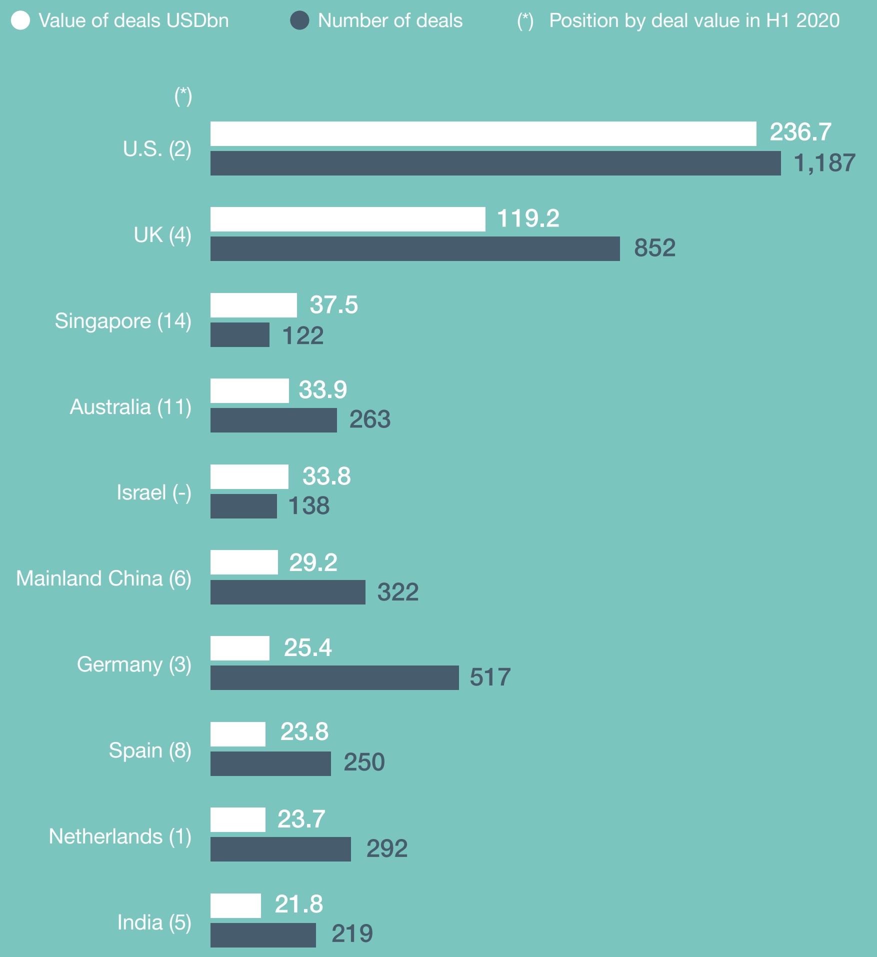
This activism has been spurred on by the #metoo and Black Lives Matter movements, but has accelerated during the pandemic and is equally apparent in the U.S., the UK and in Germany.

It is clear that, overall, the pandemic has given companies the chance to rethink work in interesting and often innovative ways.

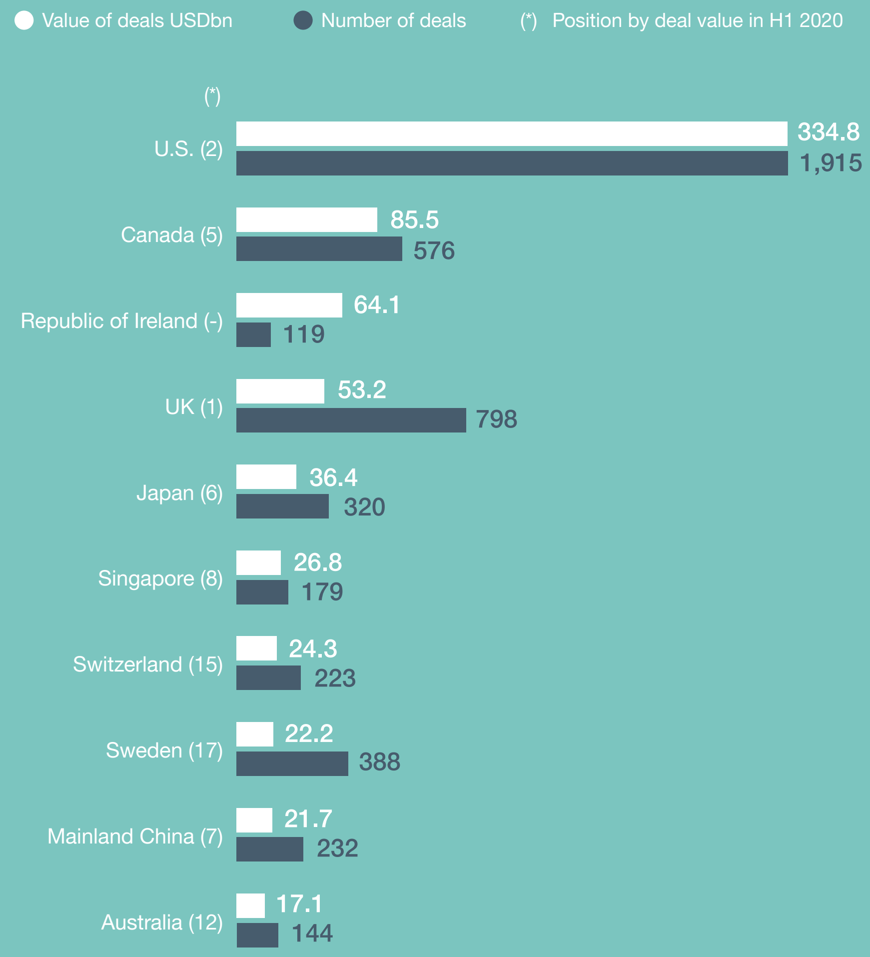
It's equally clear that the "new normal" will pose many new and complex challenges for employers and dealmakers in the months ahead.

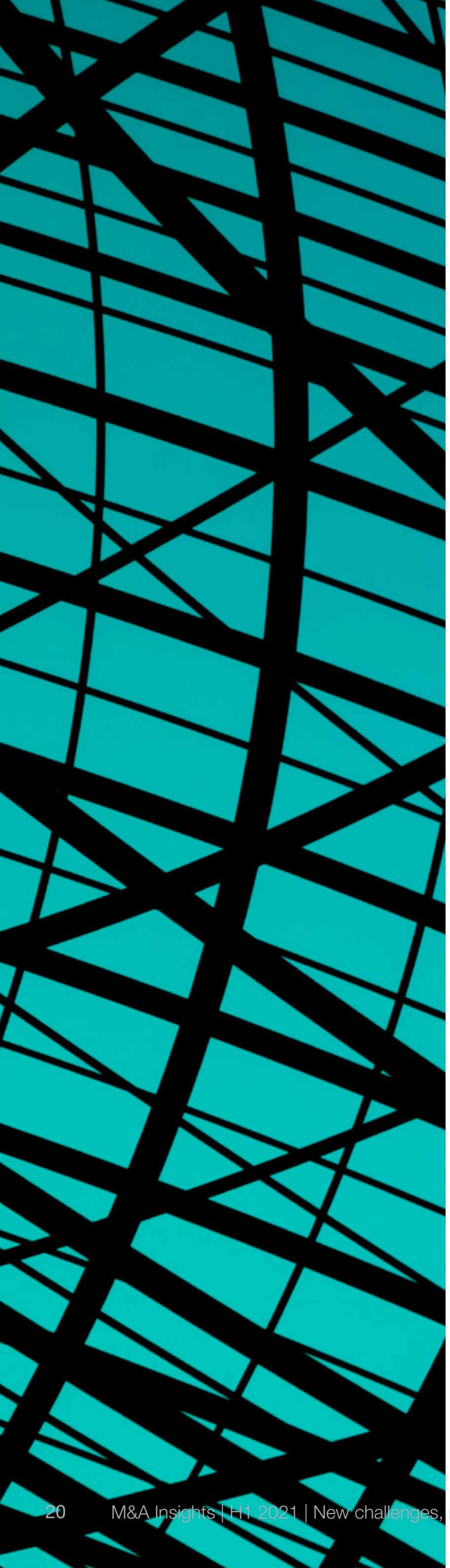
Global deal flows

Inbound target markets, H1 2021



Outbound acquirer nations, H1 2021





Indonesia eases foreign direct investment controls

While many governments around the world are tightening controls on FDI, Indonesia is one of only a few countries moving in the opposite direction.

The Indonesian government has now published the long awaited new investment list under Presidential Regulation No 10, 2021 (recently amended by Presidential Regulation No 49 of 2021), one of the mandates that came out of last year's so called Omnibus Law, officially known as the Job Creation Law.

That Indonesia should be bucking global trends on FDI controls needs, however, to be seen in context.

Previously, it was at the top of the list of countries prohibiting or curbing overseas investment – a long-standing concern and frustration for potential investors.

Our analysis shows that Indonesia had more industries where investment was restricted or subject to complex licensing requirements than any other country in Southeast Asia.

Sectors opening up to foreign investment

The new regulation amends the negative list previously set down in 2016. Amongst sectors where an outright prohibition on FDI or shareholding caps have been removed are:

- **Telecoms**
- **Construction (where shareholding caps of between 0 and 75% applied before)**
- **Drilling services**
- **Distribution**

Those sectors where FDI controls still apply include media, shipping and traditional industries and crafts.

Meanwhile, as before, financial services are carved out of the negative list but subject to their own set of regulations.

Investors should exercise some caution

Investors will undoubtedly welcome these liberalisations and the new regime is likely to increase Indonesia's perceived attractiveness as an investment destination.

However, they need to proceed with some caution.

Although the idea is that the Presidential Regulation should be the main mechanism for controlling FDI, separate restrictions can be imposed in key sectors at a ministerial level.

So while investment in a telecoms business may be allowed under the new law, the Ministry of Telecommunications may still exercise the right to impose controls and restrictions.

Carve-out deals likely to increase after Covid-19

Carve-out and spin-off deals are likely to accelerate as companies emerge from the Covid-19 pandemic. Increasingly, companies are looking at alternative strategies to boost their competitiveness, increase their profits and create value for shareholders.

Not only does a carve-out or spin-off allow a company to do this, it also allows it to refocus on its core businesses and improve operational efficiencies without having to spend time and resource on non-core and/or underperforming business units.

2019 was the second busiest year of the last decade for spin-off transactions, and although deal volume was affected by the pandemic, we still saw some multi-billion dollar deals last year, such as United Technologies' USD19.5bn spin-off of Otis Elevator and Siemens' USD18bn spin-off of its conventional power and renewable energy business.

PE funds were particularly active in 2020, with some of their largest acquisitions involving carved-out business units, for example EQT's near EUR1bn acquisition of hand sanitiser producer Schülke from French industrials group Air Liquide and KKR's GBP4.2bn acquisition of Pennon's UK waste management business, Viridor.

We expect them to feature heavily in the months ahead as they look to deploy a surplus of accumulated dry powder.

But with a shortage of attractive standalone businesses coming to the market, it is likely that other financial buyers and strategic players will also contemplate buying carved-out business units.

Likely trends in the year ahead

Pre-pandemic shifts in key markets plus the direct impact of the crisis, for instance the way it has accelerated the adoption of new technologies, will reshape the priorities of big corporate players.

Businesses that have weathered the pandemic will be rethinking their strategies in order to rebuild and take advantage of new opportunities.

The impetus for change will vary from company to company and from sector to sector. For instance:

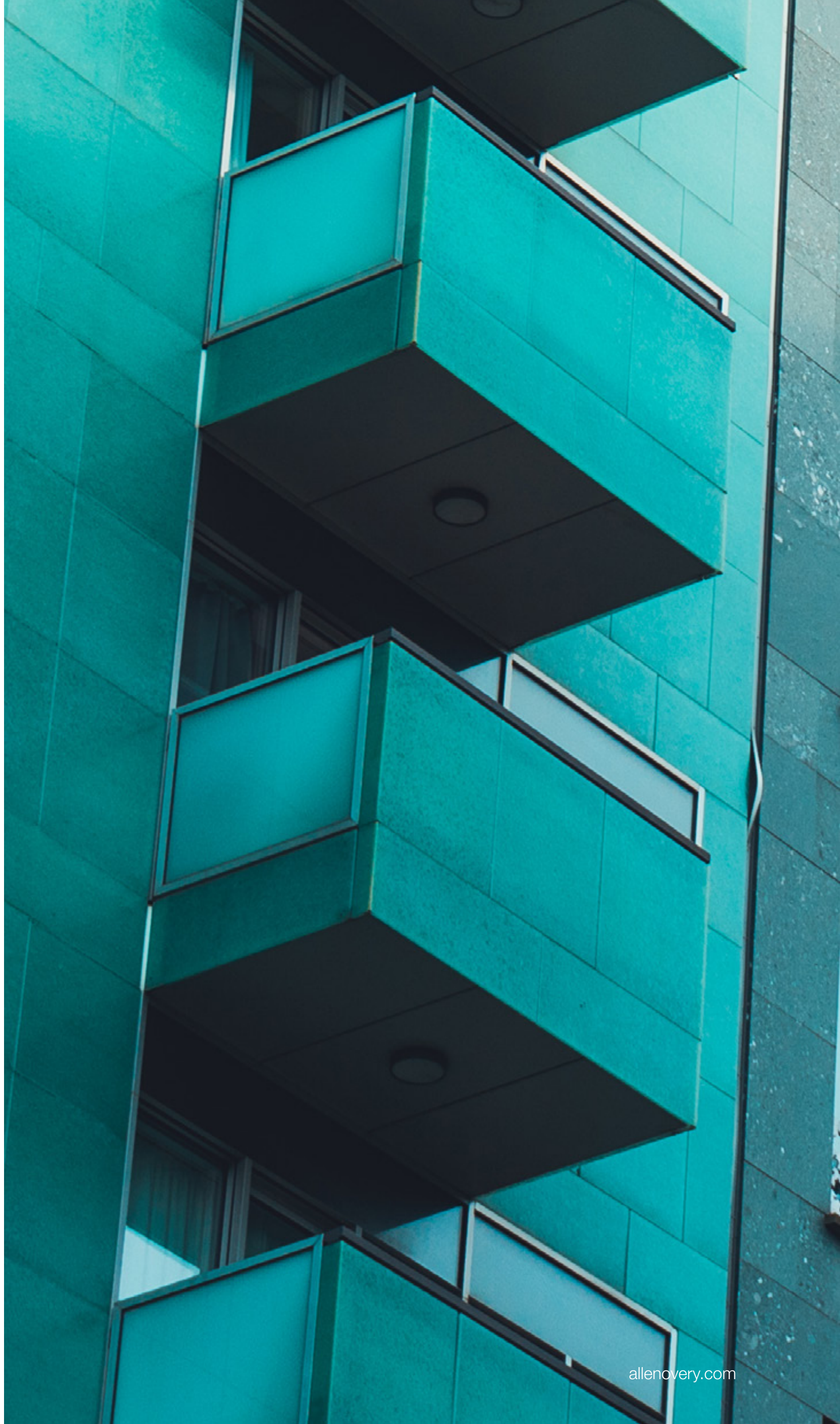
- **some companies, hard hit during the crisis, will need to increase liquidity and reduce debt. Distressed M&A deals, so far postponed thanks mostly to government support schemes, are likely to pick up as the year progresses**
- **in Covid-resilient sectors with sustained and reliable cash flows, increased valuations could drive deal activity**
- **environmental, social and governance (ESG) issues are increasingly driving boardroom decisions, including with regards to the units which no longer fit into the overall business portfolio**

But other factors will play an important role.

For instance, we expect activist shareholders, key players in forcing business to spin off non-core assets in recent years, to step up their demands for divestments to increase shareholder value.

As we described elsewhere in this report, the massive proliferation of SPACs offers big corporations another way to divest themselves of business units for cash and for carved-out business to achieve a public listing.

> "It is likely that financial buyers and strategic players will contemplate buying carved-out business units."



Carve-out and spin-off deal breakers and complexities

Carve-outs and spin-offs are rarely simple to achieve and require careful planning and due diligence.

That's particularly true of highly integrated companies where different business units may share premises, services, systems and personnel, and may have co-mingled supplier and customer contracts.

Deals can also flounder when quite far advanced, for instance if:

- **the spin-off proposal creates a large unmitigated tax liability**
- **shareholder approvals and relevant antitrust clearances (including, increasingly, FDI regulatory requirements) are not secured ahead of signing**
- **due diligence reveals that the unit to be carved out in fact contains elements crucial to the success of the remaining business and a change of course is not available**

Planning for the initial separation and day one readiness, as well as for the long-term transition to operating as independent businesses, needs to start early and run concurrently. Both are equally important.

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.