Finance Magazin

This is what we expect for the M&A year 2021

The Corona crisis initially crippled the M&A market, and only since the second half of 2020 has there been a light at the end of the tunnel. Will the deals come back this year? And what has the impact of the crisis been on the transaction market?

Text: Olivia Harder

More deals, even larger volumes and even riskier investments: Many industry observers predicted that 2020 would be the year of mergers and acquisitions. But by March of last year at the latest, it was clear that the hoped-for boom in the M&A market would not materialise. Transactions were postponed or delayed, such as the sale of Baywa's wind and solar division. At the end of March, the energy group announced that the Corona crisis was complicating sales talks. Baywa finally closed the transaction in December. Other deals were cancelled completely. There is no question that M&A suddenly took a back seat in the face of the pandemic - and it stayed that way for almost the entire first half of the year.

Only when a bit of certainty and predictability returned did deals start to be tackled again. The bottom line is that the recovery in the second half of the year was enough for a mixed result: according to data from Mergermarket, the number of transactions, with 6,658 announced deals in Europe, is as low as it was last around seven years ago. However, the volume of these deals amounted to 847.2 billion US dollars, which is still an increase of more than 5 per cent compared to the previous year. "Just got off lightly" - this is how M&A advisors sum up the past year. From a German perspective, the sale of Thyssenkrupp's lift division (17.2 billion euros) and the billion-euro takeover of Varian by Siemens Healthineers (16.4 billion US dollars) contributed to the high volume.

Fewer deals, but larger ones, and a strong second half of the year: dies this already indicate a trend reversal in the M&A market? Or will 2021 again be dominated by the pandemic and its consequences?

Learning effect of the Corona crisis

Despite all the optimism, the situation on the M&A market remains fragile. "The market is naturally volatile and strongly influenced by economic fluctuations," Joachim Ringer, co-head of investment banking at Credit Suisse in Germany, points out. He warns against reflexive optimism: "Further upheavals in the Corona pandemic could have a severe impact on the M&A business."

But even if it proves true that the M&A market is weathering the Corona crisis well, the economic crisis has left traces that will be visible well into 2021 and beyond. Companies are showing caution in large deals these days, transaction security is once again the top priority. One indication of this is that companies are choosing deal structures more carefully and attaching more importance to a fair distribution of risk. "In the coming months we will also see more minority investments and joint ventures," believes M&A lawyer Thomas Krecek of Clifford Chance. The main motive for this approach: It allows the companies to get closer to the future partner without immediately taking the full risk of a complete takeover. In doing so, they still keep the door open for a purchase. M&A consultant Tobias Rieg from the investment bank Houlihan Lokey believes that another motive can

be discerned: "We see more structured elements such as earn-outs or vendor loans for some of the transactions in order to bridge different purchase price expectations."

M&A deals with shares

Companies also want to keep risk as low as possible when financing their acquisitions. They succeed in doing so by paying part of the purchase price in their own shares - a phenomenon typical of crises. "In the past five years, such 'share for share deals' have accounted on average for only 13 per cent of the total volume in Europe. From March to September last year alone, it was already around 30 percent," reports investment banker Ringer.

The advantage of this structure is obvious: if the buyer pays for a takeover in his own shares or if there is even an exchange of shares, the effect that cash becomes extremely expensive should the stock markets collapse again is neutralised. However, the Corona crisis has not only created a greater need for security among companies, but has also revealed their sometimes hidden weaknesses - be it an acquisition that was a little too expensive or high refinancing costs now putting pressure on the company's balance sheet, or even a real strategic mistake on the part of management. Whereas such situations could be covered up before the crisis they became the undoing of some companies - especially from sectors hit hard by Corona - in the middle of the crisis. But the companies have learned their lessons: "The companies know that they are under a lot of pressure to transform. They have to adapt their business models in order to survive. This is a topic that will occupy companies for at least the next three to five years," predicts Christian Saxenhammer from the Berlin M&A boutique Saxenhammer & Co.

Activists on the rise

The pressure to adapt to new circumstances has become even more pronounced as a result of the pandemic. This pressure to act will manifest itself, among other things, in spin-offs of peripheral areas that no longer belong to the core business. This has two decisive advantages during and after the crisis: First, a sale brings in fresh financial resources - which can be used, for example, for restructuring or to pay off transitional financing. Secondly, a carve-out frees up management capacities that can be used in the group for further crisis management, but also for strategic development. And the companies would do well to get their business in shape, because an investor group could become uncomfortable this year: Activists are already sounding out their chances of attack, as Patrik Czornik, head of M&A Germany at J.P. Morgan, observes.

Hedge funds such as Elliott are targeting M&A processes in which they can engage in multiples arbitrage - they buy a small stake in a takeover target and demand a higher premium from the buyer. However, the M&A consultant is sure that there will not only be headwinds from activists in 2021: "We expect a higher risk of hostile takeovers of listed companies in the aftermath of the crisis." Czornik bases his prediction on the following considerations: At the beginning of the crisis, boards could still easily argue that the share was only under pressure for a short time and that an offer had to reflect the long-term (positive) development of the company. This defence no longer works so easily. Boards must therefore build more coherent lines of argument as to why they reject an offer, Czornik believes.

Good environment for deals

Despite all the risks, there is also hope: "Companies have now experienced Corona for almost a year and can assess the further consequences of the crisis as well as the necessary measures much better," says M&A consultant Rieg. In addition, the crisis has shown that M&A processes largely function virtually. Travel and contact restrictions should therefore not be a fundamental problem for the M&A business in the future. Moreover, financing costs remain favourable (see interview on page 66), and some companies still have liquidity that they had secured during the height of the crisis. And those companies that had to take on debt in the wake of Corona could provide additional deal flow with debt-financed carve-outs.

Another factor is private equity: "Many funds are currently planning early exits in order to benefit from the current high valuations in some sectors and the generally strong IPO environment," reports M&A lawyer Stefan Bruder of Clifford Chance. The deals are also being driven by the private equity houses themselves: Their investment pressure will remain high in 2021.

Valuations remain high

But competition for attractive assets is fierce. This continues to drive up valuations, especially for companies that have weathered the crisis well, but does not represent a real deal breaker, at least for financially strong buyers. And the fantasy of the hoped-for Corona bargain is still fuelling the M&A market. One thing is certain: the past year was also challenging for M&A transactions, but 2021 will be the litmus test for companies: They have to prove that they can cope well with the "new normal". This also applies to the M&A business. Those who allow themselves to be unsettled and blocked by the continuing volatility will lose out in the long run.

olivia.harder@finance-magazin.de