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Corporate M&A 2022

USA: Trends& Developments

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Trends and Developments

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M&A Outlook in 2022

For the third year in a row, we are writing an article on the outlook of merger and acquisition transactions with tremendous uncertainty facing the business community. Two years ago at this time, we had the spectre of the COVID-19 pandemic confronting us, and last year we were in the middle of the pandemic with the prospect but not certainty of a more normal year because of the availability of COVID-19 vaccines. As it turned out, 2020 was a turbulent year for mergers and acquisition transactions, as we suspected it could be. However, last year we noted optimism at the beginning of 2021, due primarily to the rebound in M&A activity in the third and fourth quarters of 2020. We predicted that 2021 could see a full recovery in M&A activity and could be a strong year for M&A transactions.

In fact, 2021 turned out to be a record-setting year in M&A activity. There was nearly USD6 trillion in global M&A transaction volume announced in 2021, breaking the previous record of USD4.6 trillion set in 2007. The aggregate value of M&A transactions in 2021 increased more than 80% from 2020. Almost a half of 2021 transaction value came from mega-deals in the USD1–10 billion range. Remarkably, over 250 M&A transactions announced in 2021 were at valuations of USD1 billion or more. The growing need for companies to explore new opportunities through strategic transactions, which began before COVID-19, accelerated during and as a result of COVID-19; and in 2021 companies continued to seek ways to innovate across all sectors. As a result, there were more than 200 M&A transactions of at least USD1 billion targeting technology companies announced in 2021, over a half of which involved non-technology acquirors.

Similarly, M&A activity in the US surpassed previous records in 2021. For the year, the US saw more than USD2.5 trillion in M&A transaction value, exceeding USD2 trillion for the first time and nearly doubling aggregate M&A transaction value for 2020. The number of deals in 2021 (almost 7,900) handily surpassed the previous high of almost 6,500 deals in 2018, and deals valued at USD5 billion or more accounted for nearly half of all US M&A transactions.

In 2021, transactions involving private company targets accounted for over half of the total M&A transaction value, reaching almost USD1 trillion – more than double 2020's total of almost USD500 billion. Financial sponsors represented approximately 36% of the total deal value in 2021. In addition, in 2021, there were over 240 acquisitions by special-purpose acquisition companies (SPACs), an increase of 180% over 2020, and some analysts expected this number to increase in 2022.

Part of the rebound in the M&A activity in 2021 may be attributable to the relatively strong performance of public stock markets, with the S&P 500 up more than 26% for the year. This capitalisation growth offered public companies increased financial capability and boosted confidence to pursue M&A deals.

Corporate activism increased in 2021 and environmental, social and corporate governance (ESG) themes were more consciously stressed in a significant number of boardrooms. Companies, especially in the consumer goods sector, are becoming more aware of the long-term impact of owning ESG-compromised assets, as well as the potential benefits from buying ESG-positive assets. Some companies have moved forward in this area by incorporating ESG analysis into their M&A process. ESG is rapidly becoming a front-line issue for regulators, investors, customers and employees – rising up the list on corporate agendas. In a recent survey of M&A executives, 65% expect their company's focus on ESG to increase over the next three years. We note, however, out of ten elements considered important in the M&A process, ESG was the least-emphasised factor. It seems that certain companies struggle to determine how best to assess the ESG implications of an acquisition or fit ESG considerations into their overall M&A strategy.

Coming into 2022, the outlook for M&A activity was positive, with almost 70% of dealmakers expecting M&A deal volume to continue to rise in the first half of 2022. Based upon the number of deals announced in the fourth quarter of 2021, as well as anecdotal information on the number of M&A deal pitches in November and December of 2021, M&A activity in 2022 has showed no signs of slowing down. Yet, as we noted in the past, the overall economic outlook is generally the most significant factor in a company's consideration of an M&A transaction. And since the start of 2022, two distinct but related global developments arose that could impact M&A activity in 2022: Russia's invasion of Ukraine (and the responses of governments and businesses) and the rising cost of crude oil. These factors, together with the stated desire of President Biden to increase both US individual and corporate tax rates, tend to cloud the outlook for M&A activity. It is possible that there could be a short-term spike in M&A transaction activity if the Biden administration succeeds in increasing the capital gains tax rate as business owners seek to complete transactions prior to the effective date of any such increase, but increased taxes could depress activity after they are implemented.

Thus, despite the general level of optimism, there are several factors that could act as headwinds for M&A transactions in 2022, including (i) unclear timing of macroeconomic cycle turns and growing concerns over inflation; (ii) spikes in COVID-19 outbreaks and/or new variants of COVID-19 causing economic setbacks, including temporary lockdowns; (iii) increased antitrust concerns and regulatory oversight; (iv) global impact of the geopolitical environment, especially the impact of the Russian invasion of Ukraine; and (v) ongoing supply chain disruptions.

Based upon the M&A activity in 2021 and subject to disruptions caused by the war in Ukraine, key factors driving M&A activity in 2022 are expected to be (i) strategic need for innovation, technology and growth; (ii) corporate carve-outs and divestitures to create value, simplify company portfolios and improve balance sheets; (iii) financial sponsors with substantial amounts of dry powder available to deploy; and (iv) attractive valuation levels and favorable tax considerations (subject to possible tax law changes) that may continue to drive acquisitions of private companies. The principal industries in which 2022 M&A transactions are expected to focus include technology, healthcare, energy, automotive, aerospace, sector-specific trends and defence.

Technology

The value of technology M&A deals announced in 2021 topped USD1 trillion for the first time. Most of the trends that drove last year's record-breaking performance appeared at the beginning of this year and are likely to continue in 2022. Based on historical trends, M&A activity in the technology sector typically declines after a year with a record surge. For example, following the record years of 2007 and 2015, M&A activity declined by approximately 40% and 20% in 2008 and 2016, respectively. Neither of those previous declines were coming after a year like 2021, in which innovation and technology as M&A drivers spiked due to the impact of remote working and working from home caused by COVID-19. Those drivers largely still exist, and we could see another banner year in technology M&A activity in 2022.

Energy

M&A activity in the energy and natural resources sectors was relatively low again in 2021 when compared to the robust M&A activity in other sectors, rebounding only around 20% when compared with 2020. It was nowhere near the pre-pandemic levels. Despite relatively low M&A activity in 2021, the drive to achieve a lower-carbon, sustainable future could drive more companies to look to M&A transactions in 2022 to make progress on this energy transition goal. Energy transition deals accounted for approximately 20% of the energy sector M&A deals greater than USD1 billion in 2021. The rising price of oil and increased energy and transportation costs, caused in part by the Russia–Ukraine war, could drive these transactions more quickly than expected. In 2022, more companies are expected to use M&A transactions to (i) transition existing operations and to strengthen environmental, social and corporate governance assets; (ii) build green energy hubs; (iii) develop an integrated chain to deliver energy transition products and services; (iv) reshape business models; and (v) invest in energy startups to acquire disruptive technology.

Healthcare

Healthcare M&A activity rebounded in 2021 from the pandemic-affected 2020, with deal volume up 16% in 2021 and total transaction value rising by 44%, to approximately USD440 billion. The good news is that 2021 saw a return to pre-pandemic trends across all five healthcare sectors: pharmaceuticals, medical technology, payers, providers and healthcare services. However, the valuations of healthcare companies reached record-high levels in 2021, which will force acquirors in 2022 to get creative by pursuing more cross-border deals, acquiring new capabilities, achieve focus, scale and specialisation, and acquiring carve-outs.

Automotive

After a drop in M&A activity in 2020 caused by the pandemic, which continued in 2021 due to the shortage of computer chips in 2021, most experts expect M&A deal volume in the automotive and mobility industry to grow in 2022. Manufacturers are expected to continue to expand their existing businesses and seek new business areas for growth through strategic M&A transactions. Industry disruptors such as electrification, digitisation and automation are requiring automotive manufacturers to intensify M&A activity to acquire critical resources and facilities to meet these unprecedented challenges on a faster timetable than would be possible through organic growth. In the past, the automotive and mobility industry undervalued M&A deals as a solution to growth and strategic capabilities. Until recently, most M&A activity focused on traditional, large transactions aimed at allowing manufacturers and suppliers to grow and generate cost synergies that historically came from economies of scale. The industry finds itself now in the most disruptive period in its history. In addition to engaging in M&A deals to acquire leadership and innovation talent, companies need to acquire new technology and innovation capabilities, especially in the following areas: (i) real customer focus, (ii) autonomous driving, (iii) connectivity and digitisation of vehicles, (iv) electrification of powertrains, and (v) shared mobility.

Aerospace and defence

Recovering from a historic downturn and growing disruption, the aerospace and defence industry is poised to experience a greater volume of M&A deals in 2022. The best companies will pursue M&A strategies to help them to emerge from these turbulent times with stronger fundamentals – namely, leadership economics, innovative capabilities and greater diversification.

Nearly two years into the biggest decline in commercial aviation history, the industry is only back to about half of its pre-pandemic level. The recovery has been much slower than industry experts had hoped for and even expected. This prolonged recovery may never see a full return of profitable business travel. If this turns out to be accurate, airlines would be pressured to squeeze their original equipment manufacturers (OEMs), which would pass this financial pressure down through each layer of the supplier base. Because of potentially competing technologies, the industry must honestly evaluate the sustainability of the industry as operated historically.

Commercial aviation continues to struggle with what the post-COVID-19 recovery means and what the "new normal" of air travel will look like. On the other side of the industry, defence companies face budget uncertainty and growing competition from new companies. Both sectors have begun to look to M&A deals to strengthen their personnel, talent and financial fundamentals and to better position themselves for growth. Original equipment manufacturers, prime contractors, and tier 1 suppliers have already consolidated to a large degree. This should trigger more M&A activity in the lower tier of the industry and within the fragmented supplier base. The landscape of the defence and space sectors is rapidly evolving as a result of the geopolitical environment and pace of technological innovation. New competitors have arisen with substantial capital and appear poised to pursue their own M&A deals. Companies that effectively pivot to use M&A transactions, divestitures and joint venture partnerships to enhance their portfolios and acquire innovation capabilities and talent will likely emerge as winners.

Consumer products

Many believe that foot traffic in established retail operations is not coming back to pre-pandemic levels as consumers shift their buying behaviour, opting for the super-fast delivery of goods in what is now being referred to as "quick commerce". M&A activity is high on the agenda of large consumer goods companies as they seek to reignite top-line revenue. This growth is key to boosting shareholder returns in consumer products. Consumer goods companies are pursuing deals and choosing partners to respond to the rapidly developing quick-commerce industry. Consumer interest in rapid delivery of food, groceries and other consumer products has exploded dramatically since the beginning of the COVID-19 pandemic lockdowns. Emerging quick-commerce players and existing retailers are turning to M&A strategies to gain the capabilities needed to compete effectively. Established retailers can help quick-commerce companies scale much more quickly, and they can provide large customer bases and core retail capabilities, such as product assortment and inventory, that will attract and retain customers. Acquiring quick-commerce companies provides existing retailers with local delivery capabilities, established driver networks and delivery logistics capabilities outside of the typical retail wheelhouse.

Additional M&A themes

The following trends and themes are expected to impact M&A activity in 2022.

Supply chain management

Supply chain management technology should be a focus of M&A activity in 2022 due to the stress on the supply chain flow of goods caused by strong consumer demand.

Electric vehicle market

This emerging and rapidly growing sector could see consolidation of designers of electric vehicles and related technology with SPACs to provide capital in 2022. In addition, M&A activity could be fuelled by the USD7.5 billion earmarked for electric vehicle charging technology in the recently enacted US infrastructure bill.

Space technology

Technological advancements should continue to attract M&A activity in 2022 after the historic achievements in 2021. Blue Origin and Virgin Galactic completed their first space tourist trips last year, and SpaceX launched a successful mission. The father of all space travel, NASA, landed its rover on Mars. Morgan Stanley has estimated that the approximately USD350 billion global space industry could grow to as much as USD1 trillion by 2040. In 2021, several space-related companies went public through SPAC mergers. This trend may not continue in 2022, but earlier this year Deep Space Acquisition I, a SPAC targeting space technology, filed for a USD210 million initial public offering.

Fibre alternative

We could see a trend of fibre consolidations similar to the cable company roll-ups that occurred 20 years ago. There appears to be abundant capital to fuel M&A deals, and existing companies prepared to pursue growth by consolidating overbuilt situations.

Gaming market

COVID-19 has triggered a renewed interest in gaming, and investors have begun to take notice by allocating capital to this huge market. Some estimates of the size of the global gaming market in 2021 top USD180 billion in revenue. The mobile gaming segment, which is estimated to be near USD100 billion in revenue, is ready for consolidation because it is easily accessed compared to the other types of gaming. One example of this trend is Microsoft's announcement that it would acquire Activision Blizzard and all of its PC, mobile and platform games for USD68.7 billion.

Infrastructure deals

Infrastructure deals will continue to be propelled by high demand, with high valuations and high supply. Similarly, we anticipate a continuation of both carve-outs and existing infrastructure M&A across mobile, fixed and data centres.

Dentons Sirote has an M&A team comprised of 24 attorneys in Alabama, 16 of whom hold an LLM in taxation. As part of the global law firm Dentons, the M&A team has extensive experience in all stages of public and private company mergers, acquisitions and divestitures, as well as private offerings across a broad spectrum of industries, including insurance brokerage, healthcare, manufacturing, food and beverage, retail and real estate. The team's depth of experience and Dentons' wealth of resources allows the practice to provide highly sophisticated yet cost-effective M&A counsel to clients across the Southeast on complex matters that range across the nation and the globe. With Dentons Sirote's particular expertise in tax law, it can anticipate and address federal and state income tax issues, allowing clients to achieve their business objectives in a tax-efficient manner.

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