Optimism for UK M&A and IPOs as New Decade Begins

Partner

George D. Knighton / London

As we enter the 2020s, we begin the new decade with greater optimism than we had at the start of the previous one. In the U.K., December 2009 ended with negative growth; the government as the owner of the remains of Northern Rock and Bradford & Bingley, the majority shareholder of the Royal Bank of Scotland and the largest shareholder of Lloyds Banking Group; the employment rate at 70%; and the *Financial Times* Stock Exchange 100 down to 5,400. Ten years later, economic growth is a subdued but positive 1%, the employment rate is up to 76%, the financial sector has been almost entirely returned to private ownership and the FTSE 100 is at 7,500.

While a positive outlook for deal activity is not a certainty, market participants have several reasons to be confident.

First, following the U.K. general election in December 2019, the political situation looks to be stabilizing after a long period of turbulence. The U.K. business community has responded with hopefulness: The *Financial Times* reported that "UK Stocks Jump as Easing Political Angst Unleashes Bulls," and the City A.M. front page led with "City Looks Forward to Bojo Boom." While many in the European Union (and in the U.K.) regret the end of any last chance to avoid Brexit, the election results mean the end of the U.K.'s 10-year experiment with coalitions and minority governments and a return to an executive and legislature dominated by a single political party that will hold power for at least four years. Meanwhile, under its new leadership team of Ursula von der Leyen at the European Commission and Christine Lagarde at the European Central Bank, the EU can get on with its own priorities. Outside Europe, signs suggest that the trade war between China and the U.S. may be approaching resolution.

Second, political stability has the potential to bring with it significant structural change in the U.K. economy over the next decade, as it pivots away from the EU and toward North America, potentially driving deal growth. Although claims that the U.K. can complete comprehensive trade deals with the EU and U.S. within the next 12 months are probably overly optimistic, these deals are likely to be concluded in the medium term. The U.S. and U.K. economies already have similar emphases: The services sector accounts for 70% of U.S. output and 80% of U.K. output, and the U.S. and U.K. are the world's biggest earners from services and income, together accounting for 24% of world exports in 2017, according to *The Economist*. Previously, companies in the services sector in the U.K. might have looked to Europe for growth opportunities; however, as trade barriers between the U.K. and U.S. fall — and those between the U.K. and the EU are more likely to increase, as any trade deal is likely to be more restrictive than actual membership in the EU — trans-Atlantic acquisitions seem likely to increase.

Third, market data suggests increasing demand in the mergers and acquisitions and initial public offerings markets in 2020. After a slow start in 2019, European M&A ended the year well. Following a quiet first six months, Mergermarket reported 1,545 deals with an aggregate value of US$166.5 billion in the third quarter and a final year figure of US$770.5 billion, an overall decrease from 2018's total of US$986.4 billion. However, European outbound M&A in 2019 was much more robust, with deals

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Four Times Square
New York, NY 10036
212.735.3000

reaching an aggregate value of US$272.1 billion, an increase of 28.3% over the previous year. Those figures support the view expressed by some market participants toward the end of the year that it was "time to just get on with doing deals." The number of IPOs in 2019 was low, with only 69 completed in Europe by the end of the third quarter, compared with 154 in the same period in 2018. Rising markets and greater investor optimism may cause companies that paused IPOs in 2019 to dust off plans as market sentiment recovers in 2020.

Fourth, a significant volume of capital remains to be deployed. U.S. corporations, particularly in the technology space, continue to hold significant cash reserves. Private equity funds also continue to have significant capital, reportedly raising new funds of more than US$342.9 billion in Europe in 2019, adding further to the large amounts already raised. Funds will want to put that capital to work. Moreover, significant opportunities exist to leverage equity funds with debt. Direct-lending funds have increasingly replaced banks as providers of finance for transactions, structurally changing the European debt markets over the past decade. While these funds were previously focused on small-to-mid-market deals, increasingly, they are willing to fund larger transactions, either funding deals that banks may not have been willing to finance or providing competitive pricing that makes deals more viable. And for the largest deals, the collateralized loan obligation market remains very active.

Finally, the U.K. remains one of most open jurisdictions for M&A in the world. Though it includes some elements that overseas bidders may find frustrating, the regime of the City Code on Takeovers and Mergers and English company law continues to prioritize shareholder value. Accordingly, if a bidder's price is fair, directors are obliged to put the offer to shareholders, and most offers result in completed transactions. Acquisitions in specialist sectors, such as defense, will continue to be regulated, and it seems likely that additional legislation will be passed to increase the level of review of sales of businesses with a national security dimension. (See "Conservative Party Win Paves Way for Reforms to UK National Security Reviews.") Signs also suggest that the U.K. antitrust authorities are becoming more hawkish. That said, the U.K. has not adopted a more general foreign investment review process for "strategic assets" beyond the national security sector, thus increasing the U.K.'s attractiveness as a source for overseas investment. Even if new processes are introduced, the Johnson administration looks likely to exercise its review powers pragmatically; one of its first acts was to approve the acquisition of the U.K. defense company Cobham by a U.S. private equity buyer.

Conclusion

The new decade begins with: (i) more stable politics; (ii) a changing economy that will create opportunities; (iii) rising M&A and IPO markets; (iv) buyers with cash to deploy; and (v) an open M&A regime. Though we won't know for another 10 years whether the 2020s will prove to be a roaring decade for doing deals, as we look forward from here all the fundamentals appear to be in place.