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Needs of strategics, PE firms and SPACs led to record U.S. M&A levels, likely to sustain dealmaking in 2022

By Stephen F. Arcano, Esq., Christopher M. Barlow, Esq., June S. Dipchand, Esq., and Sonia K. Nijjar, Esq., Skadden, Arps, Slate, Meagher & Flom LLP*

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Takeaways

- The record level of M&A in 2021 was widely dispersed across industries and was driven by the strategic needs of companies to add technology and adapt to the pandemic and was supported by strong markets.
- While SPAC IPO and de-SPAC activity declined over the course of 2021, these vehicles have raised more than $138 billion that is waiting to be deployed in business combinations.
- Private equity firms were a major contributor to the boom, accounting for about 20% of all M&A, and their "dry powder" makes it likely they will remain a major driver of activity.
- Potential brakes on dealmaking — such as higher interest rates and an evolving regulatory landscape — do not currently appear to pose a serious threat to continued high M&A levels.

The ongoing economic recovery from the pandemic, fed by fiscal and monetary stimulus in developed countries, set the stage for a historic year of deal activity in 2021. Notwithstanding episodic disruptions from COVID-19, 2021 saw a record $5.9 trillion in announced M&A transactions.[1] In the U.S., the aggregate value totaled $2.6 trillion, an 82% increase over 2020.

Companies have identified strategic needs to adjust product portfolios and technological and geographic platforms to today's environment and have embraced M&A as an efficient means to these ends.

This unprecedented activity spanned all types of transactions, including strategic acquisitions and divestitures, private equity investments and business combinations led by special purpose acquisition companies (SPACs).

The activity was driven by the strategic needs of corporates and the investment mandates of financial sponsors, facilitated by strong equity markets, healthy balance sheets plus readily available financing through equity issuances and borrowings at historically low interest rates, growing sums of private capital "dry powder," and healthy boardroom confidence.

Strategic M&A: Dealmaking across most sectors

Strategic M&A activity was strong across almost all industries in 2021. After the initial shock of the pandemic, businesses around the globe adapted to, and better managed, the resulting disruptions, capitalizing on opportunities to improve operations, adopt new technologies and grow revenues. Companies have identified strategic needs to adjust product portfolios and technological and geographic platforms to today's environment and have embraced M&A as an efficient means to these ends.

Many companies also undertook divestitures and spin-offs as they continued to streamline their operations. Evolving corporate strategies, increased reliance on technology across virtually all industries and the continued benefits of scale in a competitive global economy are likely to sustain high levels of M&A in 2022.

- **Technology.** U.S. technology, media and telecom accounted for over 5,200 transactions and more than $1.1 trillion in value in 2021, increases of 71% and 34%, respectively, compared to 2020. The intense dealmaking resulted in significant part from the acceleration during the pandemic of existing trends toward the adoption of remote work, digital health care, fintech and e-commerce. Activity is likely to remain high in 2022, as innovations in technology continue at elevated levels and an array of businesses take advantage of increased opportunities to apply new technologies.
- **Health care.** Pharma, biotech and the broader medical care sector contributed significantly to the M&A numbers for 2021, with the focus on new technologies and medicines, vaccines and other health care solutions. Strong tailwinds suggest that M&A activity in the industry will remain robust in 2022 — continued interest by established companies in development

and commercialization of novel treatments, the acceleration in health care technology applications during the pandemic and a heightened focus on public health and telemedicine. In 2021, this sector generated $325.3 billion in aggregate M&A in the U.S., compared to $194.9 billion in 2020.

- **Financial services.** As noted above, the pandemic accelerated the adoption of fintech and e-commerce services and provided opportunities for revamping finance and banking business models through digitization and tech-enabled additions to existing platforms. In addition, as insurers absorbed pandemic-related losses, many turned to M&A to diversify their risks and business models, expand market share and achieve synergies and efficiencies. As a result, activity in the financial services sector was strong in 2021 and is expected to continue to be robust throughout 2022. In 2021, the industry saw $360.5 billion of M&A in the U.S., up from $150.1 billion the year before.

SPACs: Despite disruptions, billions in 'dry powder'

The SPAC market was a roller-coaster in 2021. Following a record 2020, SPAC IPO and de-SPAC activity remained strong in the first three months of 2021, with 298 IPOs priced and 97 announced de-SPACs (mergers of target companies with SPACs).

The SEC has made clear that it will continue to scrutinize SPAC disclosures and accounting practices, and the agency is slated to propose new rules for SPACs in 2022.

Things slowed significantly in the second and third quarters due to regulatory and accounting issues and changing investor sentiment. The fourth quarter saw a rebound, but deal levels were still below those in the first quarter, with 163 SPAC IPOs priced and 61 de-SPAC transactions announced.

Nonetheless, compared to 2020, the number of SPAC IPOs priced and announced de-SPAC transactions more than doubled in 2021. SPACs priced a record-breaking 613 IPOs, a 147% increase over 2020's 248, and announced an unprecedented 267 de-SPAC transactions, a 178% increase over the 96 in 2020.

As of December 31, 2021, over 500 SPACs collectively were holding in trust over $138 billion in IPO proceeds — "dry powder" — and were seeking an M&A target. This dynamic has heightened competition for targets, which in some cases required creative deal structures. We expect to see increasing financial and structuring innovations to facilitate continued transactions by SPACs.

The SPAC market faces pressure from both market forces and regulators. Shareholders have increasingly decided to redeem shares prior to the completion of the de-SPACs, and the market for private investment in public equity (PIPE) financings, a crucial source of additional capital to fund de-SPACs, tightened.

These developments have forced dealmakers to reevaluate target prices and look for alternative ways to fund de-SPACs. In addition, more de-SPAC deals were terminated in 2021 than in previous years, although the 2021 termination rate did not meaningfully increase compared to 2020 or 2019, given the greater number of announced deals in 2021.

Given the growing amounts of committed capital at their disposal and the attractive debt financing terms available, PE is expected to play a major role in the M&A market in 2022.

The SEC has made clear that it will continue to scrutinize SPAC disclosures and accounting practices, and the agency is slated to propose new rules for SPACs in 2022. (See "SEC Expected To Introduce Host of New Rules in 2022, Enhance Enforcement."[2] In addition, see our January 6, 2022, client alert for recent developments in Delaware, "Court of Chancery Issues SPAC-Related Decision of First Impression."[3])

Despite these challenges, SPACs seem to be addressing a market need, and we are cautiously optimistic that de-SPAC activity will remain strong in 2022, given the number of SPACs seeking targets and the staggering amounts of dry powder they hold. (See "Choppy Market for SPACs and PIPEs, Competition for Targets Spurs Deal Innovations."[4])

Private equity: Increased activity, evolving capital raising and potential challenges

As noted above, PE-backed M&A activity remained strong in 2021, continuing the momentum exhibited in the second half of 2020, with an aggregate U.S. value of $1.2 trillion, over 50% above the previous record from 2019. Of all U.S. PE deal activity in 2021, 22.5% was in the information technology sector, 16.6% in health care and 8.9% in financial services.

As of December 31, 2021, global PE firms held over $1 trillion in dry powder, and a number of the major PE firms are also in the process of raising new, larger flagship funds, which is likely to sustain the pace of PE M&A activity in 2022.

Like other M&A market participants, PE firms faced highly competitive markets as they deployed capital on acquisitions in 2021. However, sponsors demonstrated their flexibility, pursing an array of different deal types, from clubbed mega deals to minority investments, and everything in between, as well as portfolio company add-on and tuck-in acquisitions.

Notably, PE firms continued to find opportunities involving SPACs. Some PE managers became SPAC sponsors while others considered SPACs as potential exits for their portfolio companies.

Competition for attractive targets, concerns over the economic outlook during an unpredictable pandemic and the potential for increased borrowing costs are all factors that could have some impact on private equity activity this year. However, given the growing amounts of committed capital at their disposal and the attractive debt financing terms available, PE is expected to play a major role in the M&A market in 2022.

Shareholder activism update

Activists were a significant factor in 2021's M&A landscape, and many of their campaigns had an M&A-related thesis, whether they were pushing for sales or breakups of public companies, or to sweeten or scuttle announced deals. Activists continue to blur traditional lines, pivoting from advocating sales or opposing announced acquisitions, to launching full-blown hostile takeover offers coupled with proxy contests or consent solicitations.

The strategic need of corporations to grow earnings and optimize business platforms remains a powerful driver of dealmaking, fueled by ample balance sheet cash and readily available financing.

Additional activist opportunities may open up if companies that undertook de-SPAC transactions see shifts in their investor bases and underperform market expectations. As more traditional investors allocate capital to the activist asset class and special single-opportunity funds are formed, it is likely that significant capital will continue to be available for activist funds.

Other developments of note include the rise of ESG activism and the SEC's planned adoption of universal proxies. While these may not have a meaningful impact on M&A-themed activism, their consequences are not yet fully understood. (See "Activism Landscape Continues To Evolve."[5])

Factors likely to shape dealmaking in 2022

The current strength of the M&A market is undeniable, and conditions suggest that it will carry through the year.

However, a number of factors could potentially inhibit or influence merger activity and trends:

- **Pandemic effects.** Additional disruptions from COVID-19, such as facility limitations or closures in industries where remote work is not feasible, and ongoing supply chain disruptions, could curtail economic growth and reduce both consumer and C-suite confidence.
- **Political and regulatory factors.** Political criticism of large companies and mergers has been increasing globally, and in the U.S. and Europe in particular. Economic nationalism and national security and competition regulation are growing in many jurisdictions. In the U.S., the Biden administration and antitrust regulators have pursued novel regulatory theories and declared policies of heightened scrutiny and enforcement, mirroring a global trend. The perception of political and regulatory impediments could deter companies from some deals, although in most cases, these regulatory initiatives are likely to affect the timing more than the substance of transactions. (See "Biden's Broad Mandate Has Altered the Antitrust Landscape, Making Merger Clearance Process Less Predictable,"[6] "Deal Uncertainty Increases as Merger Control Authorities Gain Discretionary Powers of Review"[7] and "CFIUS Goes Global: New FDI Review Processes Proliferate, Old Ones Expand."[8])
- **Economic uncertainties.** For the moment, concerns over a heated economy and inflation expectations, and the prospect of increasing interest rates, have for the moment replaced apprehension over the duration of the economic cycle, unresolved trade issues and equity market volatility as the prime bogeymen. All of these could affect the perceived attractiveness of transactions.
- **Valuations and asset prices.** Steep valuations of both public and privately owned assets, as well as competition for attractive targets, could at some point dampen the interest of some buyers or result in a value disconnect between sellers and buyers more generally.
- **Environmental, social and governance (ESG) issues.** ESG considerations now figure prominently with many investors, not only as policy goals, but also from a legal perspective, given new and proposed ESG-focused rules and regulations. The impact of these and emerging regulations is not yet fully understood. However, it may affect M&A and investment decisions, depending on how vocal investors are and what form new regulations take.

While all of these concerns merit attention, at this time none appear to be an immediate threat to strong M&A activity in 2022. The strategic need of corporations to grow earnings and optimize business platforms remains a powerful driver of dealmaking, fueled by ample balance sheet cash and readily available financing.

PE buyers, other private capital sources and SPACs hold substantial capital, which they remain eager to deploy, particularly if asset prices come down. Absent significant disruption, these factors should continue to support significant transaction levels this year.

Notes

[1] Sources for the data in this article include Deal Point Data, PitchBook, Refinitiv and SPACInsider.

[2] https://bit.ly/3rn9XLM

[3] https://bit.ly/3rqKilG

[4] https://bit.ly/3GeKOqS

[5] https://bit.ly/3rTxaEu

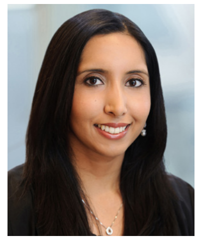
[6] https://bit.ly/3sg4BkF

[7] https://bit.ly/3rqY1Jb

[8] https://bit.ly/3L9PWAo

About the authors



(L-R) **Stephen F. Arcano**, a mergers and acquisitions partner in **Skadden, Arps, Slate, Meagher & Flom LLP**'s New York office, serves as a global head of the firm's transactions practices, advising clients on corporate governance and securities laws matters. **Christopher M. Barlow**, also a mergers and acquisitions partner in the firm's New York office, focuses on corporate governance, private equity, special purpose acquisition companies, securities and general corporate law matters. **June S. Dipchand**, a corporate partner in the firm's New York and Toronto offices, practices in mergers and acquisitions, securities law and general corporate law matters. **Sonia K. Nijjar**, a corporate partner in the firm's New York office, represents clients with mergers and acquisitions, divestitures, activist investor situations, private equity investments and minority investments. This article was originally published Jan. 19. 2022, on the firm's website. Republished with permission.

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