2022 Edition

US M&A: FINDING OPPORTUNITY IN THE UNKNOWN

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FOREWORD

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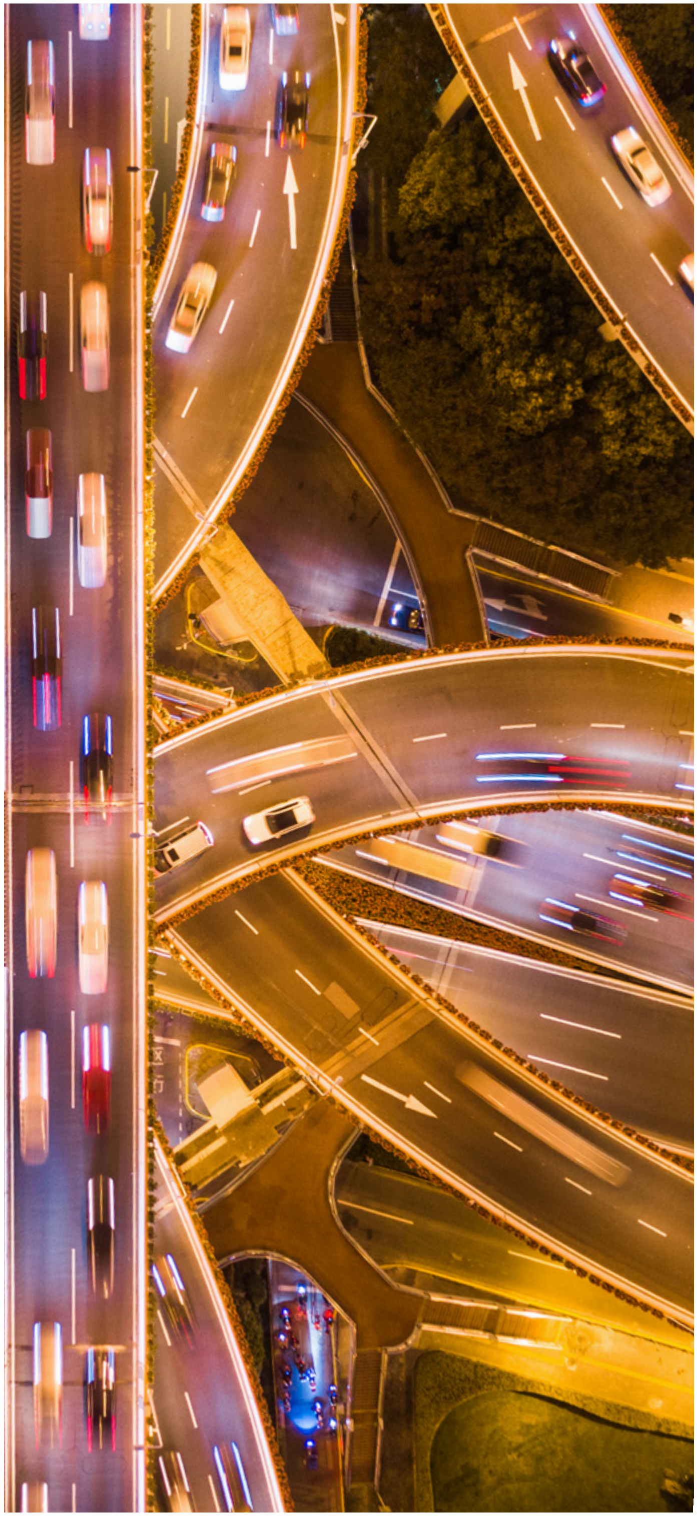
The M&A market in the United States has been on a rollercoaster ride. The post-pandemic resurgence took dealmaking to never-before-seen highs, thrust upwards by the settling in of the new administration in Washington, widespread vaccine uptake and the reopening of the economy. However, this burst of activity soon lost momentum, with deal activity peaking in mid-2021.

Since then, markets have been consumed by risk-off sentiment. The year began with the continued sell-off of growth assets as investors succumbed to inflation concerns and the prospect of numerous rate hikes and balance sheet shrinking by the Federal Reserve. Even more disruptive has been Russia's invasion of Ukraine. Markets do not respond well to uncertainty and the tragic events in Europe have inevitably exacerbated existing concerns.

The Fed finds itself in a difficult position. On the one hand, prices have been spiraling—in March, the Bureau of Labor Statistics' consumer price index measure of inflation rose to 8.5% compared to last year, the fastest annual increase since 1981. On the other, growth is stalling following the post-pandemic boom. If the Fed raises rates too aggressively, it may overshoot and cause a recession. Indeed, the yield curve on two-year and 10-year treasuries briefly inverted in April, potentially signaling problems ahead: each of the last eight recessions, dating back to 1969, were preceded by such an inversion.

While that outcome is not guaranteed—and with the Fed's monetary intervention making the indicator less predictive than it has been in the past—this all spells further uncertainty. Markets are in a unique and unpredictable situation, which is unconducive to big-ticket M&A as companies attempt to understand what lies ahead.

Private equity (PE) will likely be the exception. The industry possesses mountains of dry powder and, while monetary tightening will make debt coverage more costly in leveraged buyouts, PE firms are experts in capitalizing on market dislocation and have a risk appetite that strategic buyers cannot match. This means, come rain or shine, that PE should be expected to remain in the market as an active buyer.



KEY FINDINGS

Most corporates surveyed (65%) expect to undertake 1-3 deals over the next 12 months, but almost a quarter (24%) say they won't undertake any. In comparison, almost three-quarters (71%) of PE respondents expect to undertake at least four deals.

Most respondents expect the bulk of their activity to be domestic in nature. Moreover, the vast majority of corporates surveyed (88%) say they do not intend to pursue any major cross-sector deals over the next 12 months.

For a quarter of all respondents, the number-one driver of their M&A activity over the next 12 months will be capturing synergies between the businesses. Just over one-fifth (21%) emphasize pursuing diversification of products and services.

For the largest group of respondents overall (23%), the number-one potential impediment to their M&A plans is difficulties conducting due diligence. Relatedly, 14% of respondents (the next largest group) cite the ongoing impact of COVID-19.

Among the roughly half of respondents who were surveyed once it had become clear that the war in Ukraine would not be resolved quickly (from March 7 onwards), 19% identified geopolitical concerns as the number-one potential impediment to their dealmaking plans over the next 12 months.

Almost all respondents (around 94%) are concerned about potential US policy developments and regulatory changes. Most PE respondents (51%) say they are somewhat concerned, whereas the bulk of corporates (59%) admit they are very concerned.

Both corporates (92%) and PE respondents (85%) agree that ESG developments will impact dealmaking over the next 12 months. However, fewer than half (43%) of corporates and just one-third of PE respondents think they will have a very significant impact.

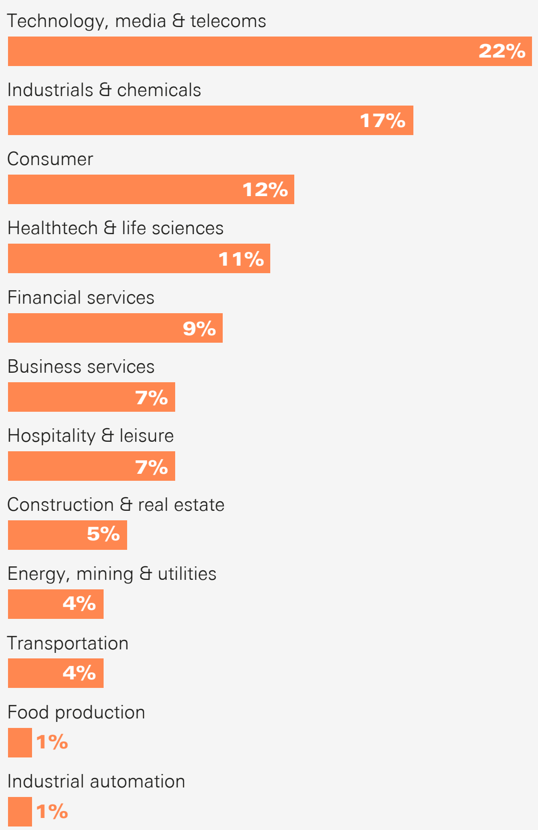
More than 90% of dealmakers surveyed believe the adoption of blockchain, digital assets and/or cryptocurrency solutions will become more prevalent over the next 12 months, including 47% of corporates and 56% of PE respondents who expect the adoption of these technologies to become much more prevalent.

METHODOLOGY

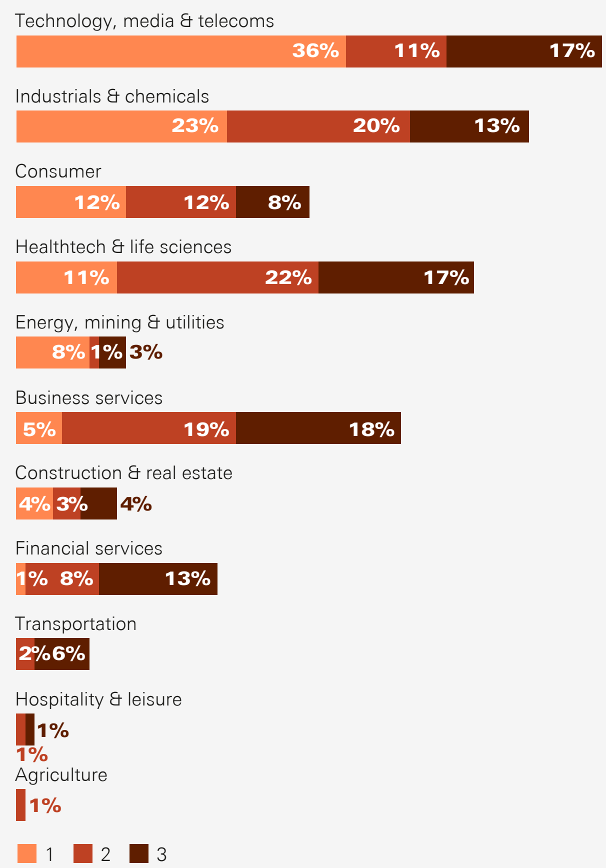
In late February and early March 2022, Mergermarket surveyed 75 PE and 75 corporate executives based in the US to gain insights into the country's changing policy environment and how this may impact M&A. All responses are anonymous, and results are presented in aggregate.

Just over one-fifth (22%) of corporates surveyed operate primarily in the TMT sector. The next largest share (17%) specialize in industrials & chemicals. Like their corporate counterparts, PE respondents prioritize TMT (36%) and industrials & chemicals (23%). Sizable shares also highlight healthtech & life sciences (22% of second-place votes) and business services (19% of second-place votes).

In which of the following sectors does your company primarily operate? Corporate only
(Select one)



What are your main sectors of focus? PE only
(Select up to three and rank 1-2-3 by order of significance, where 1=most significant)



INTRODUCTION

Taken as a whole, there is much to be positive about in the performance of the M&A market in 2021. "Rebound" does not begin to cover it—a total of US$2.6tn was invested through the year, a new high-water mark and a 100% gain on the previous year. Volume was also abundant, with 8,195 deals recorded in the US versus 5,732 for 2020, a considerable gain of 43%.

However, a more granular view shows signs of the market having topped out midway through 2021, peaking in Q2. That three-month period claimed 30.3% of the year's total value invested. The deceleration continued into 2022, with Q1 M&A in the US falling by 13% from the preceding quarter to US$506.22bn.

Russia's invasion of Ukraine has clearly shaken investor confidence, although there are other headwinds. Government pandemic assistance was critical in supporting Americans and bringing much needed demand back into the economy. That stimulus has since come to an end, however, and the Fed is pivoting toward monetary tightening. This means the cost of financing will increase at the same time that growth will be stifled.

The effect of this is evidenced in our research, in particular among corporates surveyed. Almost all of these strategic buyers (96%) say they undertook between 1-3 M&A deals in 2021, but just 65% expect to match this in 2022. There is a notable split here from PE buyers, who remain committed to dealmaking in 2022 despite the more precarious macroeconomic outlook.Perhaps surprisingly, geopolitical disruptions do not seem to be having much impact on respondents' international dealmaking appetite, despite there being numerous examples of companies focusing on relocating their supply chains and sourcing closer to home. A third of corporates believe they'll make cross-border acquisitions in 2022, matching last year's findings.

One of the defining policy proposals of the current administration has been an increase to the headline corporate tax rate, with initial plans to raise it from 21% to 28%, though a compromise of 26.5% seems more likely. President Biden's federal budget sent to Congress on March 28 once again proposed this hike, in part to address necessary new spending for the Defense Department and Justice Department to help secure NATO allies in light of recent geopolitical events. Tax concerns, however, do not appear to be a huge obstacle. The bulk of our respondents (43%) say their dealmaking appetite would be unchanged in the face of US tax reform.

Instead, it is the ongoing challenges of the pandemic and the threat of antitrust actions that are playing most on investors' minds. Nearly two-in-five investors (39%) say that merger scrutiny will be among the three greatest impediments to their dealmaking activity in 2022, and 59% of respondents say increased scrutiny of M&A by authorities would significantly decrease their dealmaking appetite.

As Michael Sibarium, partner in Pillsbury's antitrust and competition practice, explains, "Following the playbook of President Biden's Executive Order for Promoting Competition, the Federal Trade Commission (FTC) and the antitrust division of the Department of Justice (DOJ) have embarked on an aggressive effort to reign in mergers that senior administration officials assert have resulted in too much market power and concentrated wealth in the hands of too few large players."

On March 31, Federal Trade Commission chair Lina Khan was quoted as saying that bipartisan support for stronger antitrust enforcement against tech giants like Facebook and Google "reflects a mandate for decisive action." Similarly, Jonathan Kanter, the head of the Justice Department's antitrust division, said acquisitions of startups by larger players should be closely scrutinized because such deals risk weakening competition in the US economy. These public comments follow the launch of a competition probe by the EU and the UK into an advertising arrangement between Google and Meta, formerly Facebook.

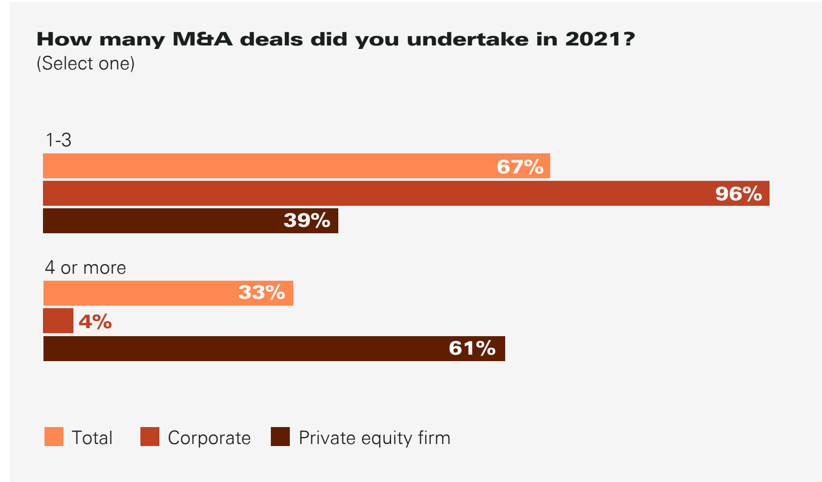
The more aggressive position taken by authorities is definitely an area to watch. Judging by recent activity and rhetoric, it is likely that most agencies' bandwidth will be trained on the Big Tech players that have faced public opprobrium in recent years. Therefore, the perceived scale of this threat may, at least to some extent, be exaggerated. But at the very least, dealmakers should factor in longer timelines and the potential for agency involvement or investigations post-transaction.

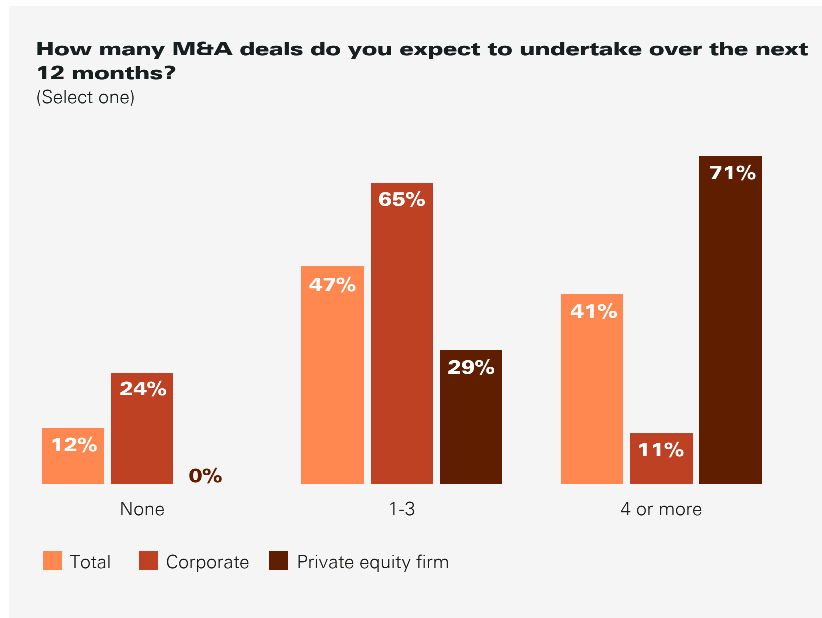
Without a doubt, 2021 was an exceptional year for US M&A, and it will be difficult for 2022 to repeat those highs. But for the time being, optimism seems to be outweighing pessimism, despite the odds.

"The injection of uncertainty... caused some investors to pause and others to pivot, but it has not changed the fact that there is ample dry powder and opportunities abound."

Veronica Nunn
Partner in Pillsbury's corporate practice

PLANNING FOR UNCERTAINTY





Last year was a wild ride for the US M&A market, as our data makes clear. Almost all corporates (96%) report undertaking between 1-3 M&A deals in 2021. PE respondents were more prolific, with 61% undertaking four or more.

But we may have seen the peak. Deal activity has been losing steam in recent months, albeit following an unprecedented spike. The post-pandemic narrative has been usurped by concerns over persistent inflation, what Fed measures to rein this in mean for the economy and, of course, the tense geopolitical situation in eastern Europe.

Looking ahead, the bulk of corporate respondents (65%) expect to undertake between 1-3 deals over the next 12 months, but a sizable share (24%) say they won't undertake any. PE players, by comparison, expect to remain quite prolific, with 71% penciling in at least four deals.

The gap between last year's announced transactions versus this year's expected dealmaking may appear to show a deterioration in confidence, but a direct year-on-year comparison of expectations shows investors were actually less bullish about their forward-looking deal activity a year prior. When asked in 2021 how many transactions they were likely to undertake, 59% of corporates said between 1-3 deals. Overall, this is relatively optimistic for 2022, especially in light of recent stock market volatility and slowing growth.

"We're expecting a strong year for PE M&A," says Veronica Nunn, partner in Pillsbury's corporate practice. "The injection of uncertainty, for instance with the invasion of Ukraine, caused some investors to pause and others to pivot, but it has not changed the fact that there is ample dry powder and opportunities abound."

The Ukraine conflict does not appear to be denting appetite for outbound US activity either. While both corporate and PE respondent groups expect the lion's share of their dealmaking to be domestic, this is par for the course, as M&A tends to be focused on local markets. More than a third of strategics (34%) anticipate making cross-border deals in 2022, and this was also true a year prior. PE investors are more domestically focused, with just 23% anticipating international deals. This split between investor types is persistent and reflects the fact that PE funds in general mint smaller deals than their corporate counterparts, tending to consolidate in their own backyard, especially in the mid-market.

Indeed, the vast majority of PE respondents (93%) expect to undertake lower mid-market deals (less than US$500m), while over two-thirds of corporates (69%) report the same. The disparity between the two groups narrows as deals grow in size, though PE dealmakers are always keener to transact across all value ranges.

But even in the case of financial sponsors, a higher proportion foresee cross-border deals than a year ago, when only 17% had plans to transact overseas. This suggests that acquirers are taking a long-term view and are looking beyond current geopolitical events, despite concerns about what the invasion of Ukraine means for securing supplies in eastern Europe and the heightened sense of political risk that businesses face amid diplomatic tensions.

As one director of corporate development says: "Geopolitical concerns cannot be predicted because of the current warlike climate. The supply chain challenges are also difficult to predict at this point, especially if procurement is done from Russia and neighboring regions."

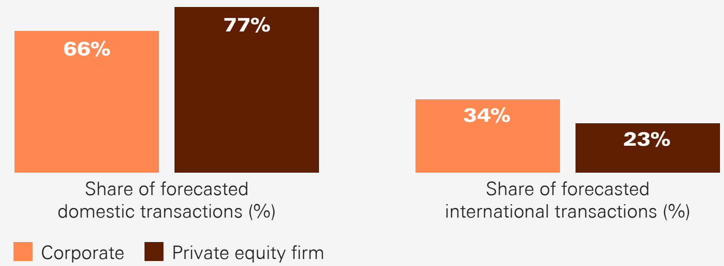
Turning to cross-sector activity, companies appear to be sticking to what they know best. The vast majority of corporates (88%) say they have no intention of pursuing any major cross-sector deals over the next 12 months. This suggests the focus right now is on cost synergies and bolstering revenue growth. Rather than taking on additional risk by pursuing strategic pivots through the acquisition of businesses in adjacent industries, corporates are doubling down on their existing strategies.

> "Rather than be disrupted by digital developments, companies want to be more proactive and become the disruptors. They are investing heavily in digital assets to strengthen their market position."
>
> —**M&A Director**, Corporate

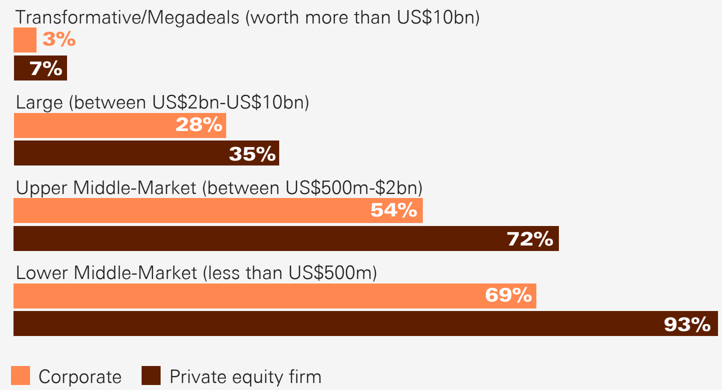
93%

of PE respondents expect to undertake lower mid-market deals (less than US$500m), compared to two-thirds of corporates (69%)

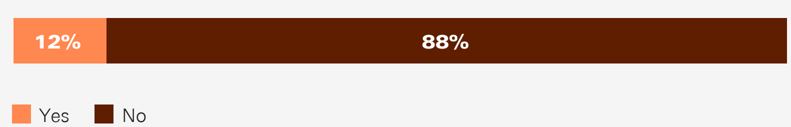
For M&A deals you expect to undertake over the next 12 months, approximately what proportion will be domestic versus international?
(Answers should add up to 100%)



What size of M&A deals do you expect to undertake in the next 12 months?
(Select all that apply)



Do you intend to pursue any significant cross-sector deals over the next 12 months? (Corporates only)
(Select one)



SPAC Season

There was seemingly nothing stopping special purpose acquisition companies (SPACs) in 2021, a banner year for these cash shells. There were 684 SPAC IPOs globally raising US$172.3bn in 2021, both record-breaking figures. According to Dealogic, 57% of US IPOs in 2021 involved a blank-check company. It's safe to say that SPACs have made their mark and continue to account for most listing activity in the US in early 2022.

This trend has not bypassed the PE industry. More than two-fifths of PE respondents (43%) report undertaking a transaction in the US in 2021 involving a SPAC, versus just 7% of corporates who say the same.

Corporates are becoming more open to working with blank-check companies, with just under a quarter (24%) reporting that they expect to be involved in at least one US M&A deal over the next 12 months involving a SPAC. PE respondents, too, expect to see an uptick in this activity, with over half (61%) forecasting their involvement in a SPAC-related deal.

However, the upsurge in SPAC activity has not been without its complications. Following the initial boom in SPAC IPOs in Q1 2021, the Securities and Exchange Commission (SEC) weighed in on the market in April last year with a statement on the accounting practices of these vehicles, requiring them to restate their financial results because many had incorrectly classified certain shares that they offer to investors, known as warrants, as equity rather than liabilities.

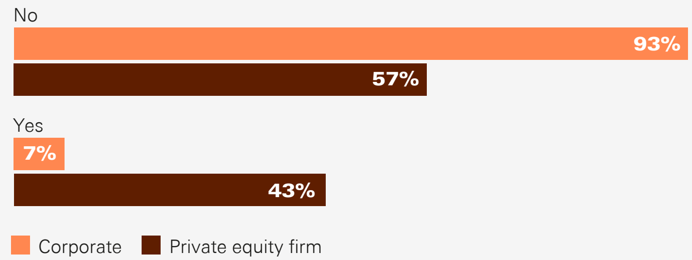
On March 30, 2022, the SEC proposed new rules that would enhance disclosures and increase potential liability for misleading revenue projections after scores of SPACs struggled to deliver on their promises once they found their merger targets. These developments have made public market investors more wary of SPACs, with cash redemption rates rising to above 80% in early 2022.

This regulatory push has rattled PE firms. Just under three-quarters (72%) are concerned about stricter SPAC-related regulation, including 43% who say they are very concerned. Understandably, given their lesser involvement with these vehicles, corporates are comparatively unfazed—61% say they are not at all concerned about the potential impact of greater SEC oversight.

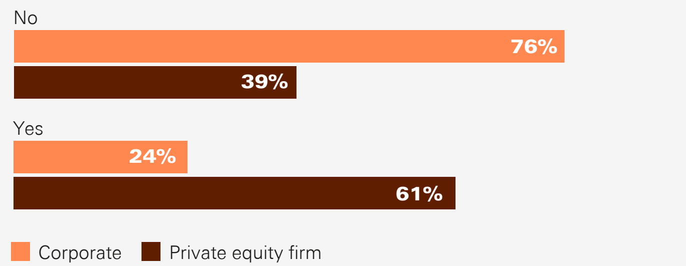
"The focus of 2022 will be the ability of existing SPACs to consummate successful mergers while navigating the recent unease of shareholders and PIPE investors."

Stephen C. Ashley
Partner in Pillsbury's capital markets practice

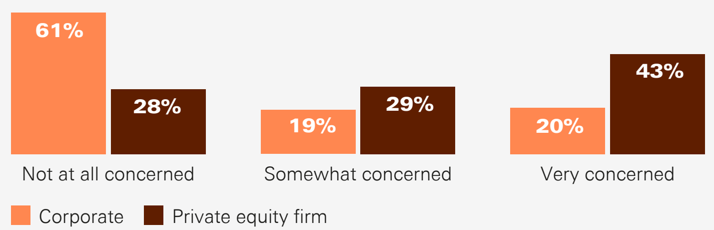
Were you involved in at least one M&A transaction in the US involving a special purpose acquisition company (SPAC) in 2021?
(Select one)



Do you expect to be involved in at least one M&A transaction in the US involving a SPAC over the next 12 months?
(Select one)



How concerned are you about the potential impact of stricter SPAC-related regulation?
(Select one)

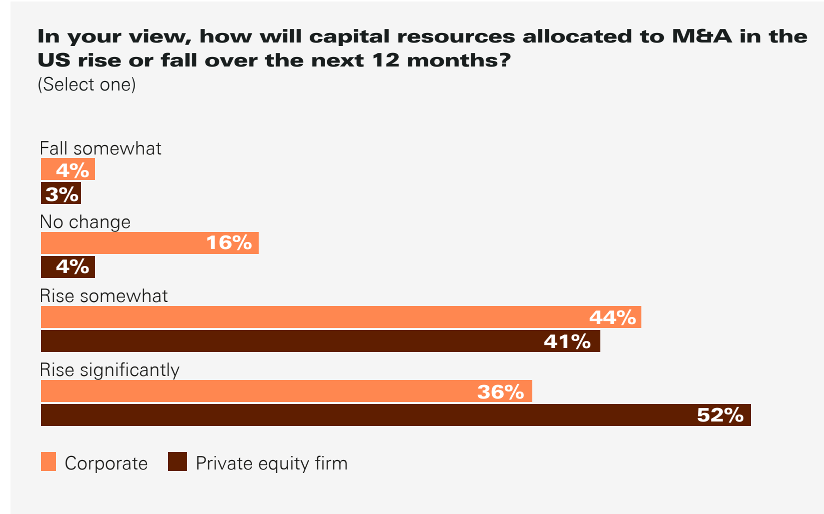


Capital Resources

Warning signs have been building in recent months. The S&P 500 sold off heavily in January, before Russia invaded Ukraine, which only added to the risk-off sentiment. For the most part, however, acquirers are holding firm, PE players remaining particularly bullish about their prospects.

More than half of financial sponsors (52%) expect capital resources allocated to M&A in the US to rise over the next 12 months, with 36% of corporates sharing this view. This differential may illustrate PE's greater risk appetite and the fact that funds are opportunistic acquirers. It has been demonstrated through business cycles that PE funds that deploy aggressively during periods of economic weakness deliver market-beating returns. So, if a recession is on the horizon, this will be a deployment opportunity for PE, while strategics are more likely to focus on their core activities.

The PE industry continues to attract vast sums of capital, the largest funds in its history being raised with relative ease. Investors have been starved of yield for years, with government stimulus weighing down on fixed income returns and pushing investors out along the risk curve into alternative asset classes. Global dry powder levels began 2022 at a record US$1.81tn, according to data group Preqin. Almost all respondents expect PE dry powder to play a prominent role in driving M&A over the next 12 months, including 88% of PE respondents who say it will play a very prominent part.



"There is a lot of dry powder chasing opportunistic infrastructure investments, and on the public side there is an expectation of substantial funding to be deployed in connection with the bipartisan infrastructure bill."

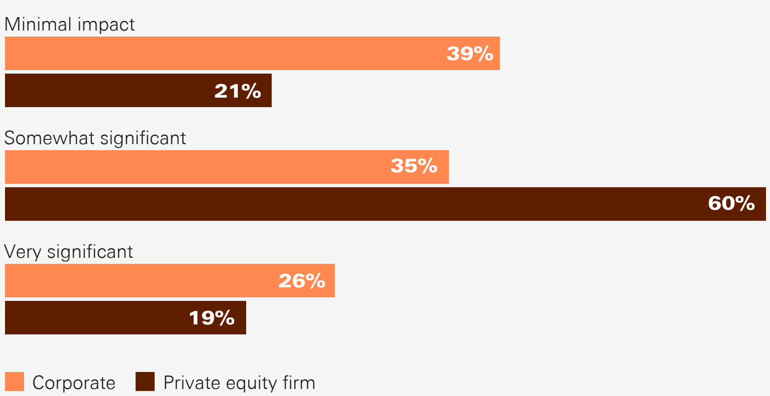
Veronica Relea
Partner in Pillsbury's finance practice

Recent infrastructure legislation may be a further boost to PE fundraising and create opportunities to deploy that capital. In November 2021, the House of Representatives passed the US$1.2tn bipartisan infrastructure package, which includes around US$550bn in new spending over five years.

"Infrastructure fundraising has grown, with PE sponsors increasingly looking to infrastructure investments for steady returns, value generation through environmental sustainability goals and the scaling of decarbonization technologies, and more generally in support of the energy transition," explains Veronica Relea, partner in Pillsbury's finance practice. "There is a lot of dry powder chasing opportunistic infrastructure investments, and on the public side there is an expectation of substantial funding to be deployed in connection with the bipartisan infrastructure bill. It's certainly an exciting time to be an infrastructure investor."

Most PE respondents (79%) believe these developments present a significant opportunity for their capital raising, investment and dealmaking efforts over the next 12 months. Corporate respondents are less bullish overall—61% say it will have a meaningful impact, though that includes just over a quarter (26%) who believe it will have a very significant impact, versus 19% of PE dealmakers who feel the same way.

How significant an opportunity do you think recent infrastructure legislation presents for your capital raising, investment and dealmaking efforts over the next 12 months?
(Select one)




CHANGE IS THE
ONLY CONSTANT

Digital transformation was the primary driver of M&A activity last year, according to our research, but respondents' priorities have changed. The traditional emphasis on capturing synergies between businesses figures highly now, which may reflect shareholder demands for growth and the fact that inflation punishes large cash holdings, which may be put to better use acquiring competitors and consolidating markets. While digitalization can itself spur growth, this is not as immediate as the income statement boost from an acquisition.

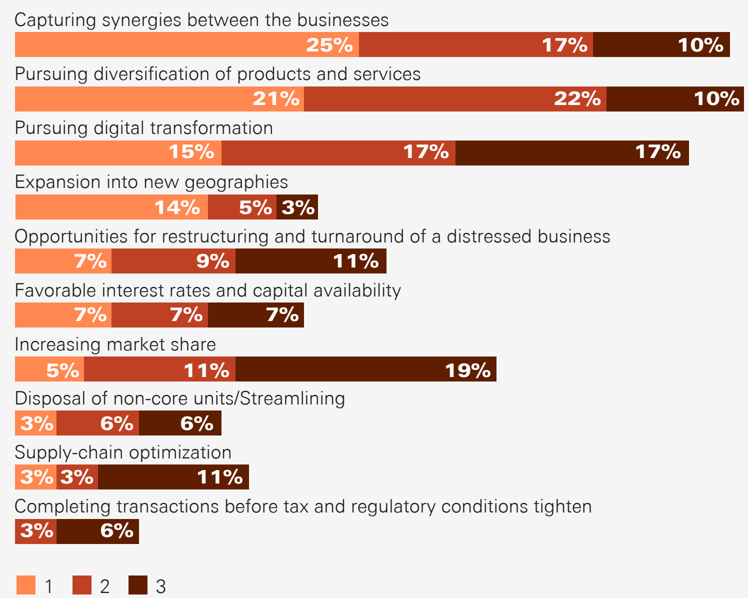
A quarter of respondents cite the pursuit of synergies as their number-one M&A driver, followed by 21% who emphasize pursuing diversification of products and services, which is also a key secondary driver for 22% of respondents. The digitalization driver has not fallen away, though. Not only do 15% say this is their number-one reason for pursuing M&A right now, but digital transformation also stands out as an important secondary and tertiary motivator. As Justin Hovey, partner in Pillsbury's corporate practice, puts it, "As digital transformation is facilitating and driving M&A activity, target companies must implement digital adoption workstreams and processes company-wide to best ensure successful M&A outcomes."

The pandemic and the challenges of socially-distanced business activity brought digitalization to the fore. However, as many have observed, we are not going to go back entirely to the old way of doing things. At the very least, businesses are not going to give up the benefits they have realized from accelerating the digitalization of their operations and adopting more data-led strategies over the past two years.

This is an ongoing process. Digital transformation can help businesses enhance customer and user experiences, reduce costs, improve efficiency and grow revenues. Strategic buyers that are not classified as tech businesses continue to divest assets to raise cash and redeploy it directly into tech, with M&A being used to fast-track digital growth.

"Digital transformation is important if we're to stay ahead of the competition. We want to acquire companies that are already well-versed with the latest digital practices," says the head of M&A at a corporate.

What will be the key drivers of your M&A activity over the next 12 months?
(Select top three and rank 1-2-3 by order of significance, where 1=most significant)



"Despite regulatory uncertainties, there is a growing consensus in the business community about the increased legitimacy of the digital asset industry and that the corner has been turned."

Daniel Budofsky
Partner in Pillsbury's finance practice

Driving Toward Digital Transformation

An exciting but relatively untested area that respondents believe will become increasingly important is the adoption of blockchain technologies. In a global first, El Salvador adopted bitcoin as legal tender in October 2021, and there has been an explosion of various networks and associated cryptocurrencies, or altcoins. This has countless implications for businesses, from holding bitcoin as collateral in treasuries to accepting cryptos for payment and integrating smart contracts and distributed ledger technology to immutably record and automate transactions and store data.

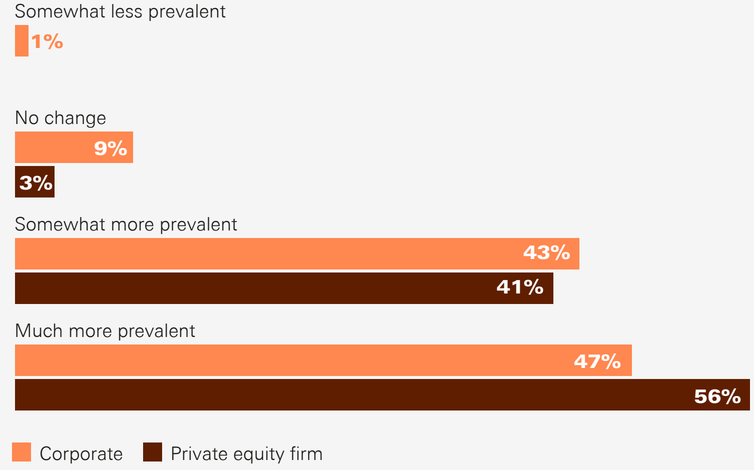
More than 90% of dealmakers overall believe the adoption of blockchain, digital assets or cryptocurrency solutions will become more prevalent over the next 12 months, including 47% of corporates and 56% of PE respondents who expect the adoption of these technologies to become much more prevalent.

"The action in blockchain has moved beyond the mere development of the underlying technology and the design of digital platforms to the commercialization of a huge variety of blockchain-based digital applications and blockchain-driven financial infrastructure, a development that is poised to touch every aspect of economic and social life," says Daniel Budofsky, partner in Pillsbury's finance practice.

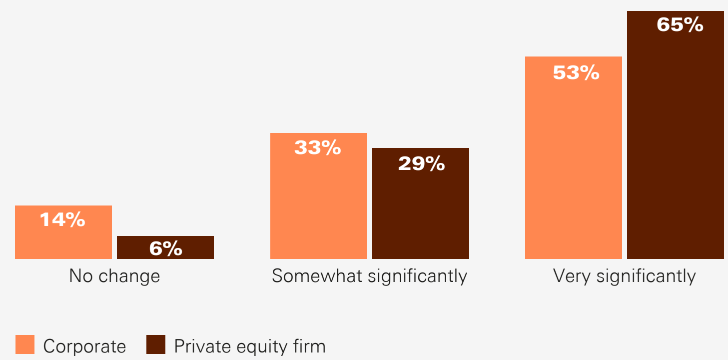
In the nascent metaverse, consumer brands in particular are acquiring virtual plots of land in projects such as The Sandbox—a blockchain-based virtual world in which users can create and trade digital assets—to get an early foot in the door and engage with their customers and communities in novel ways. These include Adidas, Samsung and Miller Lite, but even professional services firms are getting in on the action, with PwC having also acquired real estate in The Sandbox.

While it is difficult to gauge how this will play into M&A, most corporates (86%) and almost all PE respondents (94%) think developments in the metaverse will have a significant impact on deal activity over the next 12 months, including over half of corporates (53%) and almost two-thirds (65%) of PE dealmakers who believe the impact will be very significant. Certainly, the metaverse and wider crypto space has become a major point of focus for the venture capital industry. According to a report by Galaxy Digital, VCs poured US$33bn into crypto and blockchain startups in 2021, or 5% of all global VC money for the year.

How much more prevalent do you expect the adoption of blockchain, digital assets and/or cryptocurrency solutions to become over the next 12 months?
(Select one)



How significantly will developments in the metaverse impact M&A and private equity dealmaking over the next 12 months?
(Select one)



> "The Federal Trade Commission (FTC) and the antitrust division of the Department of Justice (DOJ) have embarked on an aggressive effort to reign in mergers."

Michael Sibarium
Partner in Pillsbury's antitrust and competition practice

Optimism, but Not Without Obstacles

Investors may be largely optimistic about their forward-looking deal activity, but that does not make them any less cognizant of the risks that lie ahead. In this respect, the pandemic still looms large despite the world coming to terms with COVID-19 and adjusting to the new reality.

For the largest group of respondents overall (23%), the number-one potential impediment to their M&A plans is difficulties conducting due diligence, which has been complicated over the past couple of years by travel restrictions and less willingness to meet in person to conduct asset reviews.

Tech has been an enabler amid these conditions. Virtual data rooms have already been used for years to facilitate legal and financial due diligence, allowing buyers to access confidential documents and verify financial records and contracts. Since the pandemic, however, investors have had to think more creatively to carry out operational and environmental diligence, including using tech such as videoconferencing and even drones for virtual site visits.

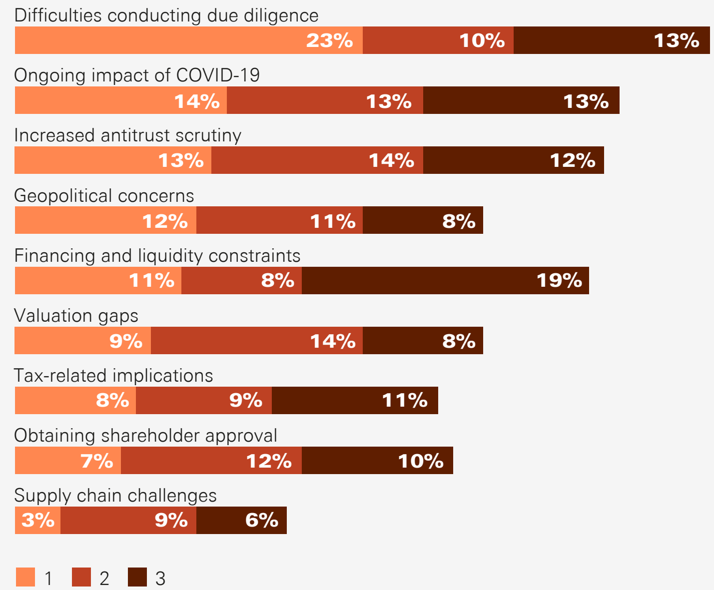
On the topic of what types of due diligence have seen the greatest increase in scrutiny over the past 12 months, 41% of respondents point to operational diligence. At 24%, financial reviews garner the next largest share of first-place votes, as well as 29% of secondary ballots.

Relatedly, 14% of respondents, the next largest group, cite the ongoing impact of COVID-19 as the greatest potential impediment to M&A. While vaccine drives have curtailed COVID-related deaths, respondents' concerns have been substantiated by renewed lockdowns in some markets, none more important than China. The country continues to pursue a zero-COVID policy while it attempts to stem the biggest breakout in infections since the pandemic began, with full lockdowns going into place across Shanghai on March 29, 2022.

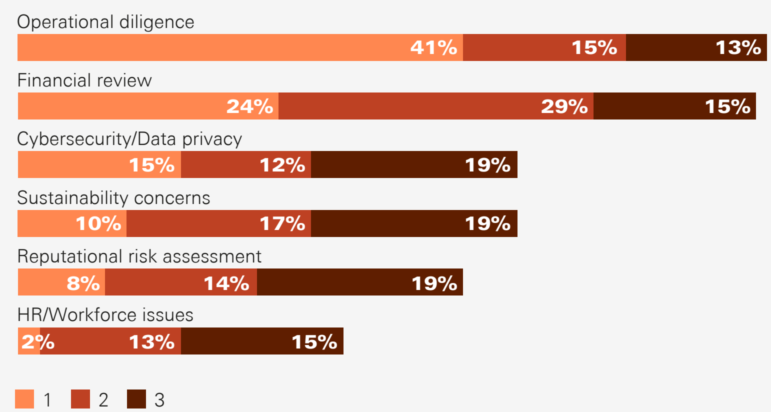
The Biden administration has said the US will focus on vaccines and therapeutic remedies to stop the spread of the virus in future rather than go into further lockdowns, though this does not prevent individual states from taking matters into their own hands. Nevertheless, lockdowns in other countries continue to impact upon business growth. For example, China's most recent actions have squeezed supply chains as cargo handling has been massively disrupted, only adding to existing inflationary pressures.

Increased antitrust scrutiny is another factor that a sizable minority of respondents (13%) identify as the number-one potential impediment to M&A. And just behind antitrust issues, 12% of respondents identify

What core aspects of dealmaking present the greatest potential impediments to your M&A plans over the next 12 months?
(Select top three and rank 1-2-3 by order of significance, where 1=most significant)



Which aspects of M&A due diligence have seen the greatest increase in scrutiny over the past 12 months?
(Select top three and rank 1-2-3 by order of significance, where 1=most significant)



"Difficulties conducting due diligence are bound to increase because of the changing regulatory climate and the restrictions as a result of the COVID-19 pandemic. We might find digital solutions useful to some extent."

—**Managing Partner**, PE

geopolitical concerns as the number-one potential impediment. The lower precedence of geopolitics may come as a surprise; however, the timing of this year's survey demonstrates how quickly risk priorities can change and that Russia's invasion of Ukraine is indeed weighing heavily on dealmakers' minds.

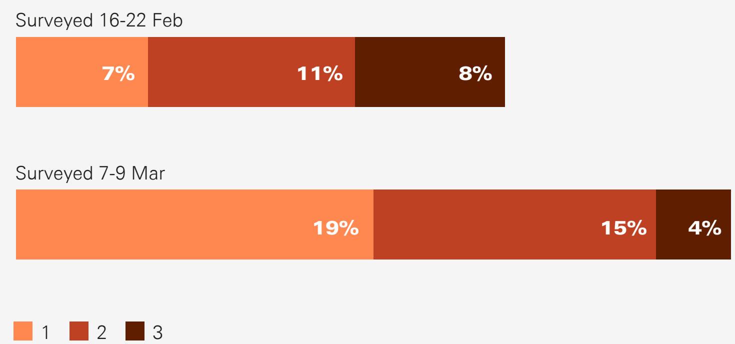
Among the roughly half of respondents who were surveyed from March 7 onwards—by which time it had become clear that the war in Ukraine would not be resolved quickly—19% identified geopolitical concerns as the greatest potential impediment to their M&A plans over the next 12 months, tied for first place with difficulties conducting due diligence. In contrast, only 7% of respondents surveyed before the invasion commenced said geopolitical concerns were the greatest potential impediment.

"Geopolitical concerns have increased since Russia invaded Ukraine. We do not know what other countries could get involved in the rift that is already affecting trade and commodity prices," warns the head of M&A at a US corporate.

"As digital transformation is facilitating and driving M&A activity, target companies must implement digital adoption workstreams and processes company-wide to best ensure successful M&A outcomes."

—**Justin Hovey**, Co-leader of Pillsbury's M&A group

What core aspects of dealmaking present the greatest potential impediments to your M&A plans over the next 12 months? Geopolitical concerns selection
(Select top three and rank 1-2-3 by order of significance, where 1=most significant)



Policy Evolution

The regulatory and policymaking landscape is quickly shifting in the US, with both positive and negative potential consequences for investors. These range from greater climate disclosures, heightened scrutiny of mergers, higher taxes and historic levels of federal infrastructure investment.

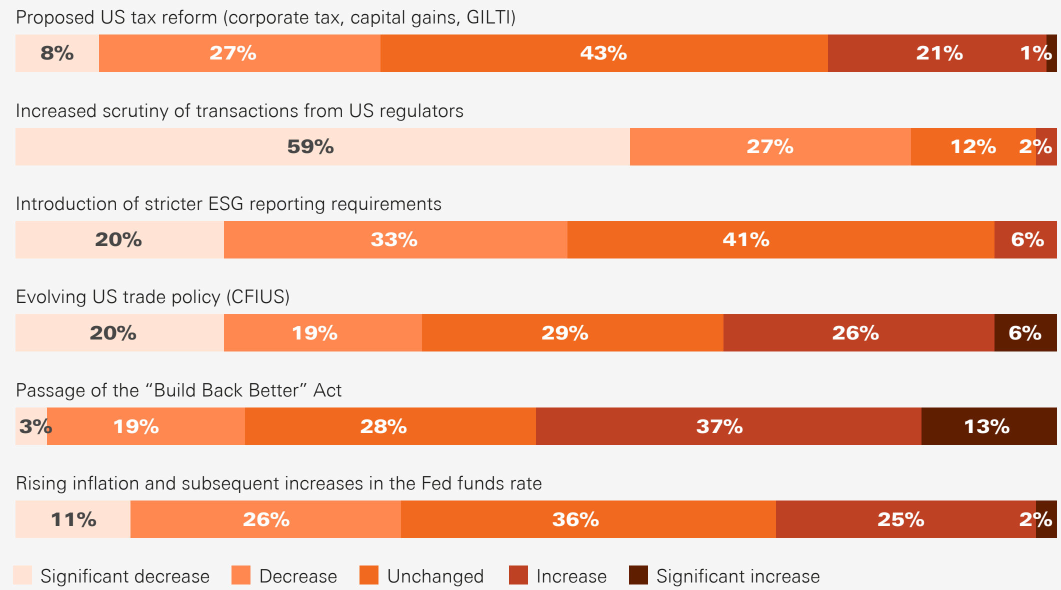
Almost all respondents (92% of corporates and 96% of PE dealmakers) are concerned about these many moving pieces. Most PE respondents (51%) say they are somewhat concerned by policy developments, whereas the bulk of corporates (59%) divulge that they are very concerned.

By far and away the biggest threat to dealmaking activity in the eyes of investors among these many changes is the potential for increased antitrust scrutiny—86% of all respondents say this would sour their appetite for deals, including 59% who say it would lead to a significant decrease.

Investors have good reason to be apprehensive. In his proposed budget, Biden wants to allocate an additional US$227m to the FTC and DOJ's antitrust division, representing a 44% hike in funding, to crack down on monopolies and anti-competitive deals. He also appointed Lina Khan, a prominent Amazon critic, as head of the FTC.

While "Big Tech" has been the primary target of much of the antitrust rhetoric from Washington, Biden also issued an executive order on July 9, 2021 calling on federal agencies to set rules aimed at lowering prices and boosting competition among companies in sectors ranging from agriculture to pharmaceuticals. "US policy developments could affect the valuation of companies. If the antitrust norms become stricter and the scrutiny into deals increases, then deal volumes will decrease," says the strategy director of a US corporate.

What would be the impact on your organization's appetite for dealmaking if the following scenarios unfold?
(Select one answer per scenario)



Another core policy priority of the current administration has been pushing for improved ESG standards and disclosures. Among other considerations, Biden's executive order on climate-related financial risks calls for financial regulators to analyze potential associated threats to the US financial system. Gary Gensler, chair of the SEC, has also called for mandatory disclosures on climate risks and has indicated the agency will move as quickly as possible on this. Change is coming thick and fast.

As Jonathan Ocker, partner in Pillsbury's executive compensation and benefits practice, underlines, "ESG is informing the business strategies of almost every company as they each strive to remain relevant and attractive to their customers, employees, partners and shareholders in a world where climate change, social justice and public health are paramount."

It should come as little surprise then that both corporates and PE respondents (92% and 85%, respectively) agree that ESG developments will significantly impact dealmaking over the next 12 months. For financial sponsors, the sustainability credentials of a deal target can influence how fundamentally appealing an asset is and determine whether the fund chooses to pull the trigger on a deal.

"The attractiveness of companies is quite dependent on the ESG principles and guidelines they have adopted," says the managing director of a PE firm. "Dealmakers are looking for the presence of compliance officers and higher transparency with ESG information."

However, most of those respondents believe the impact will be somewhat limited—under half of corporates

“Although we were expecting the Biden administration to have a different view of regulations and economic reforms compared to the Trump administration, we were not expecting such drastic changes.”

—**Managing Partner**, PE

(43%) and just one-third of PE respondents think ESG developments will have a very significant impact.

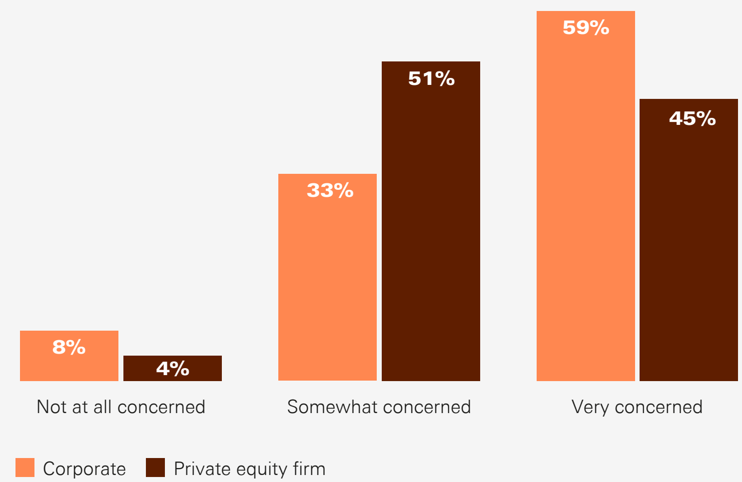
And that's not to say the impact of ESG and climate-related policies will be negative. On the contrary. The current administration's "Build Back Better" bill was killed when Joe Manchin, senator for West Virginia, pulled his support for the legislation. The likelihood of it being passed looks doubtful given that it requires unanimous Democratic support. But if the legislation—which included US$555bn for clean energy and climate change provisions—were to pass, half of all respondents believe it would presage an increase in their dealmaking, including 13% who say it would lead to a significant increase in activity.

Respondents are also largely indifferent to the prospect of tax reform, whether that be corporate tax, the capital gains rate or global intangible low-taxed income. As much as 43% of those surveyed report that their dealmaking appetite would remain unchanged in the face of updates to the tax system.

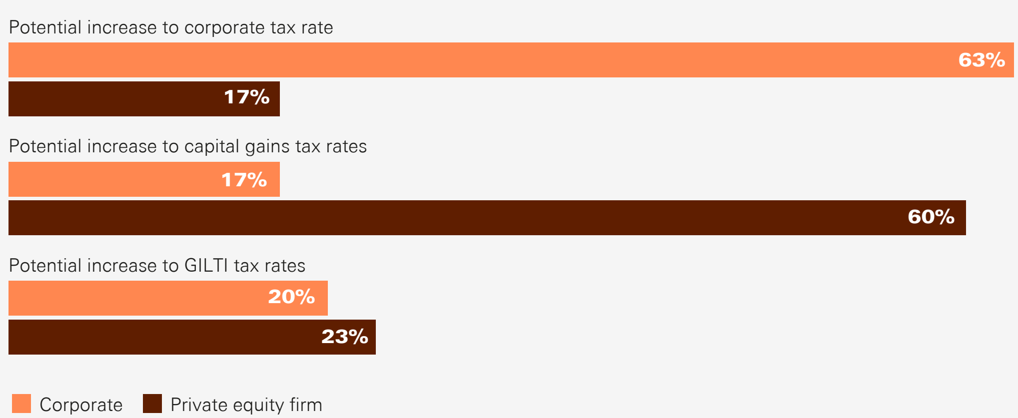
While it was initially intended that the corporate rate would be raised to 28%, pushback from Manchin has meant that House Democrats have reportedly compromised on a more moderate rate of 26.5%. Whether changes to the tax code affect M&A flows or not, they are still a matter of concern, and for different reasons.

When asked to consider the various types of tax reforms of most concern, the split between corporates and financial sponsors is clear and predictable. Most strategic acquirers (63%) are most apprehensive about a potential increase in the corporate tax rate, while 60% of PE respondents are most concerned about potential increases to the rate of capital gains tax. For the former, it would mean smaller profits; for the latter, it would mean taking home less carried interest.

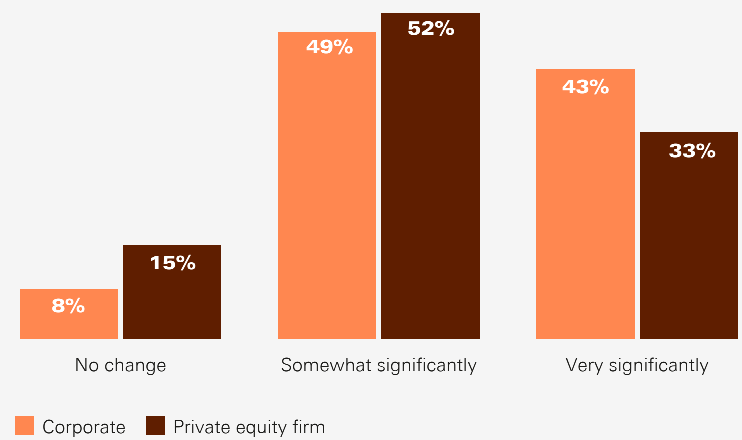
From an M&A perspective, how concerned are you about potential US policy developments and regulatory changes?
(Select one)



Which aspect of potential US tax reform is of greatest concern to you?
(Select one)



How significantly will ESG developments impact M&A and private equity dealmaking over the next 12 months?
(Select one)



CONCLUSION

There's little doubt that risk sentiment has taken a turn for the worse. Stock market volatility has arrived in response to monetary tightening and has been exacerbated by geopolitical events. This, inevitably, has had a negative impact on M&A as investors adopt a more cautious approach, waiting for clarity on the situation in Europe before committing capital to acquisitions. PE players are the exception, remaining active in comparison to corporate buyers.

It bears repeating that 2021 was a stand-out year and came off the back of an exceptionally challenging 2020, with deal activity rocketing on the back of the post-pandemic economic rebound. It is also worth noting that COVID-19 continues to pose challenges to supply chains and contribute to inflation. This is a highly complex environment with few, if any, precedents.

With this in mind, and taking into account the market feedback gleaned from this report, we advise that dealmakers consider the following maxims for the 12 months to come, which look to be defined by markets with heightened sensitivity to macroeconomic and monetary developments, as well as considerable political and policymaking risk.

Dive deep on operational and financial due diligence. Supply chains continue to face significant disruptions from all sides. Not only has Russia's invasion of Ukraine affected companies far and wide, but lockdowns in China also have far-flung implications. It is important that acquirers not only drill down into the integrity of operations at their deal targets but also, where possible, understand direct and indirect supply chain risks. Understanding how well a company is managing the impact of inflation is also critical.

Seek exponential growth amid a slowing and stagflationary economy. Growth is slowing and the risk of recession has increased amid rates of inflation not seen for decades. Corporates will need to seek out sub-sectors and markets that can drive their top lines in spite of these headwinds, using M&A as an entry point. For sector-agnostic PE funds, the focus should tilt toward areas of the economy that can show exponential secular growth that is decoupled from GDP performance, such as digital assets and crypto, genomics, robotics and artificial intelligence, and businesses that are adjacent or feed into these emerging industries.

Prepare for greater antitrust scrutiny. The current administration is stepping up efforts to assess potentially anti-competitive deals. Given the rhetoric to date, Big Tech is likely to bear the brunt of the FTC's increased resources, but buyers should nevertheless be prepared for deal timelines to be extended or agencies to launch investigations once acquisitions have closed. This is of particular concern for corporate acquirers rather than PE funds, although aggressive roll-up plays by financial sponsors may also come under the microscope.

Don't underestimate the impact of ESG. The vast majority of investors say that ESG issues are likely to affect their dealmaking. This is a long-term trend and there will only be more standards and disclosures expected of both corporates and investment managers alike. Neither should lose focus of this or underestimate the compliance burden that is coming. But perhaps more importantly, ESG will be among the biggest value drivers over the next decade.

About Pillsbury

Pillsbury advises market-leaders, innovators and financial sponsors on M&A and Private Equity transactions in the Technology, Life Sciences, Energy and Financial industries. With more than 650 lawyers located in key deal markets across the U.S., Europe, and Asia, Pillsbury is consistently ranked by Bloomberg, Factset, Refinitiv and others as one of the Top 20 most active law firms for M&A, and our lawyers have been cited by Chambers and The Legal 500 as preeminent advisers in the field.

To learn more about our global M&A and Private Equity practices, visit pillsburylaw.com.

JUSTIN D. HOVEY, PARTNER
CO-LEADER OF M&A GROUP
justin.hovey@pillsburylaw.com
+1.415.983.6117

JONATHAN RUSSO, PARTNER
CO-LEADER OF M&A GROUP
jonathan.russo@pillsburylaw.com
+1.212.858.1528

STEPHEN B. AMDUR, PARTNER
LEADER OF PRIVATE EQUITY GROUP
stephen.amdur@pillsburylaw.com
+1.212.858.1135

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Mergermarket is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

For more information, please contact:

Alissa Rozen
Tel: +1 212 500 1394