The GameStop effect | China, sanctions and cross-border investment | Where have all the distressed deals gone?

M&A monitor

Q1 2021

Inside the SPAC boom: from Wall Street to the world

Freshfields Bruckhaus Deringer

2021 gets off to a flying start

In our first M&A monitor of 2021 we take a deep dive into SPAC transactions, which have risen to become one of the principal drivers of global deal-making. We calculate just how much M&A activity SPACs are responsible for, examine what underpins their explosive growth and look at what this primarily US phenomenon means for the rest of the world.

In researching the trend we discovered some startling statistics, including that US SPACs have spent more on overseas targets in the past three months than in the previous 20 years combined.

As far as Q1's deal data is concerned, the bull run that began in Q3 2020 shows no signs of slowing. M&A through the first three months of the year broke the $1tn barrier for the third consecutive quarter. Q1 may even end up as the largest quarter ever once the final numbers are reconciled.

The biggest deals of the year so far have involved operating companies (see table on page 3), with the top two in the transportation sector: Irish aircraft lessor AerCap's acquisition of rival GE Capital Aviation Services for $31.2bn and Canadian Pacific Railway's $28.7bn buyout of Kansas City Southern.

Perhaps the most eye-catching mobility transaction, however, was the de-SPAC merger between Churchill Capital IV and electric vehicle startup Lucid Motors, which is the largest de-SPAC deal to date. The merger valued Lucid at $11.8bn, although once the private investment in public equity (PIPE) financing is added the actual valuation stands at $24bn. TMT was the top sector once again, accounting for around 30 percent of global M&A activity by both value and volume.

AerCap's $31bn deal for GE Capital Aviation Services creates a company with 2,000 jets.

Q1's top 10 deals

Buyer	Target	Value ($bn)	Deal structure	Target sector	Date announced
AerCap Holdings	GE Capital Aviation Services	31.2	Choice involving other non-cash and non-stock consideration	Financials	03/09/2021
Canadian Pacific Railway	Kansas City Southern	28.7	Cash and stock combination	Infrastructure and transport	03/21/2021
Chubb	The Hartford Financial Services Group	23.4	Unknown	Financials	03/18/2021
Rogers Communications	Shaw Communications	21.8	Cash and stock combination	TMT	03/15/2021
National Grid Holdings One	PPL WPD Investments	20.1	Cash only	Energy and power	03/18/2021
UnitedHealth Group	Change Healthcare	14.3	Cash only	TMT	01/06/2021
Investor group	Suez – French businesses	14.2	Unknown	Energy and power	03/21/2021
ICON	PRA Health Sciences	11.9	Unknown	Healthcare	02/24/2021
Churchill Capital Corp IV	Lucid Motors USA	11.8	Stock only	Industrials and materials	02/22/2021
Fintech Acquisition Corp V	eToro Group	10.4	Cash only	TMT	03/16/2021

Source: Refinitiv. Data correct to 03/24/2021

SPACs: the M&A craze that shows no sign of slowing

You don't have to go back far to find a time when SPACs had a credibility problem. Even a couple of years ago, there was a perception that they were somehow less reliable than other types of buyers, and in an auction process might not show up at closing.

Fast-forward to today and SPACs are showing up at a lot of closings. Last year, US SPACs were involved in de-SPAC deals (where the listed shell acquires, or merges with, an existing business) worth a combined $156bn, more than 4 percent of global M&A by value. Through the first quarter of 2021, **this number had risen to more than 17 percent**. Bubble or not, there are currently more than 400 US SPACs looking for targets (representing hundreds of billions of dollars of firepower, taking into account expected PIPE financing), and since most have two years to consummate a deal, they're not going away any time soon. For more insights on SPACs, visit our website.

Year	Global deal value ($bn)	US de-SPAC deal value ($bn)	US de-SPAC deal value as a % of global deal value
2017	3,302.1	19.9	0.6
2018	3,986.7	18.9	0.5
2019	3,685.6	28.2	0.8
2020	3,367.4	155.8	4.6
2021	1,113.8	196.8	17.7

Source: Refinitiv. Data correct to 03/24/2021

US de-SPAC deal value as a % of global deal value

> **A loophole in the US securities laws enables SPAC deals to be priced and marketed based on the target's financial projections, meaning SPACs can offer higher valuations than others can reach.**

What's driving the SPAC boom?

With such a surge in activity it's worth taking a step back to consider what's driving the boom. Some of their popularity stems from events of the past 12 months, but there are other factors at play.

- **SPACs are great for their sponsors**, who in most cases get 20 percent of the equity in the listed entity for an outlay of just $25,000 (although as competition for assets grows, many sponsors are reducing their "promote" as an incentive). The average SPAC IPO in 2020 raised around $336m, and while the sponsors are locked in for a period after the de-SPAC deal closes, the returns are so attractive that new sponsors keep on coming. They have to put some of their own money on the table (usually 2–3 percent of the IPO proceeds) but this is only at risk if the SPAC fails to find a target.
- **The buzz**. Since they "went mainstream" (and in a big way) last year, private equity firms, banks, institutional investors, former Wall Street CEOs, politicians and even sports stars have emerged as sponsors. FOMO has taken over to the point where the SEC has recently issued a warning about the risks of celebrity SPACs.
- **They are attractive to investors**. When a SPAC lists, investors buy $10 units that comprise a share and a fraction of a warrant (the right to buy new shares for an agreed price, usually $11.50, in the future). After 52 days, the shares and warrants split into separate listed securities. An investor can cash out in full at any time by selling the share in the market for $10 or more while holding the warrant, betting that the stock will rise above $11.50 and they can turn a profit. In addition, once the SPAC chooses its target, an investor who doesn't like the deal (or even one who does) can redeem their shares just before closing for the per-share value of the trust (typically more than $10 a share) but still hold on to their warrants. In the world of SPACs, there truly is such a thing as a free lunch.
- **For targets, SPACs are potentially an easier route to the public markets than a traditional IPO**. Significantly, the price of the target is negotiated at the beginning of the process rather than the end, reducing market risk.
- **Major PIPE investors are backing the trend**. SPACs are required to put their IPO proceeds (less a portion of underwriting commissions and IPO expenses) into a trust fund to pay for the de-SPAC transaction. However, because shareholders have the right to redeem ahead of the deal, sponsors must raise extra money to cover any potential shortfall. This is usually in the form of PIPEs in which there is huge interest from big names including Fidelity and Wellington Capital. Even though they are the "least locked up" investors, there is a sense among many that their presence gives SPACs added credibility.
- **SPACs ascribe greater value, particularly for early-stage companies**. A loophole in the US securities laws currently enables SPAC deals to be priced and marketed to PIPEs based on the target's financial projections, whereas traditional IPOs do not benefit from the same statutory safe harbor protections for the use of such forward-looking statements. This means that nascent businesses pursuing a traditional listing find it harder, if not impossible, to sell their story to the market. IPOs also have underwriters who worry about liability and historically do not permit the use of projections in their offering documents. SPACs don't have a similar underwriter-like party with these liability concerns. Unless the SEC takes action, this dynamic will continue to be used as a differentiator by SPACs facing off against other investors in auctions, with SPACs offering valuations higher than their rivals can reach.
- **De-SPAC deals can keep founders in control**. In most de-SPAC transactions, the target's shareholders end up holding the majority of the stock. Founders often emerge as the biggest single shareholders and some even get high-vote stock so they can remain in charge even as they sell their shares in the market.

SPACs go global

With so many US SPACs in the market, it's no surprise they're broadening their horizons in search of deals. In the first three months of 2021, US SPACs announced foreign acquisitions worth a staggering $48.4bn – **more than in the previous 20 years combined**. Of the 191 business combinations announced by US SPACs since the start of 2020, almost one in five (17 percent) involved a target outside the United States. Almost half of those (14 of 32) have come since January.

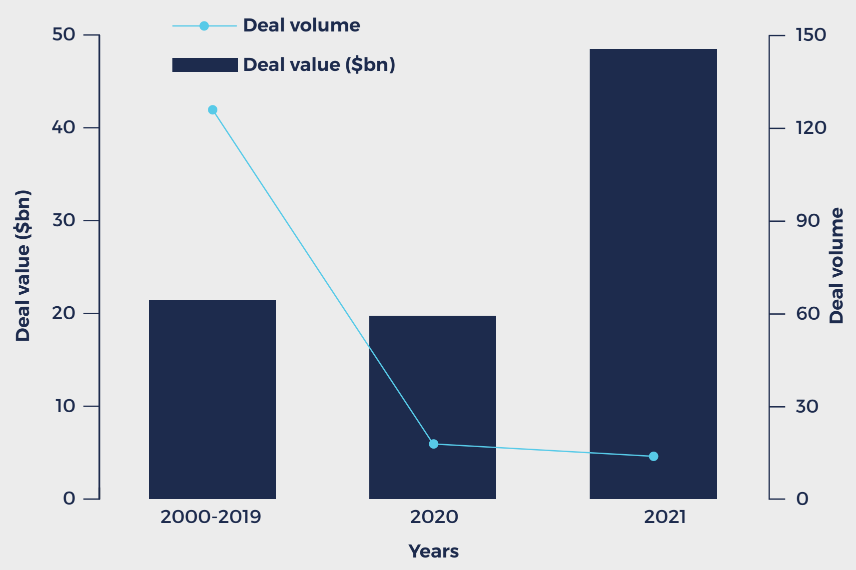
For NYSE- or Nasdaq-listed SPACs merging with overseas businesses, the US regulatory process is easier to negotiate if the target is a "foreign private issuer." To qualify, at least half the company's shares must be held by non-US residents – or alternatively, most of its assets, directors, officers and the administration of its business must be outside the United States.

For the target, the primary issue (beyond the long-term compliance considerations of becoming a US public company) is that the SEC registration process and proxy statement needed to close the deal require financial statements prepared using US GAAP (or IFRS/IASB accounting standards). In addition, those financials must be independently audited in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), the US accounting regulator. If the target company has made one or more significant acquisitions in the latest year, it also needs to provide audited financials for these deals for inclusion in the proxy or registration statement. Preparing them (or attempting to negotiate waivers with the SEC if they can't be produced) can take weeks or even months, and if the SPAC is nearing the end of its two-year clock, it may not have time to wait.

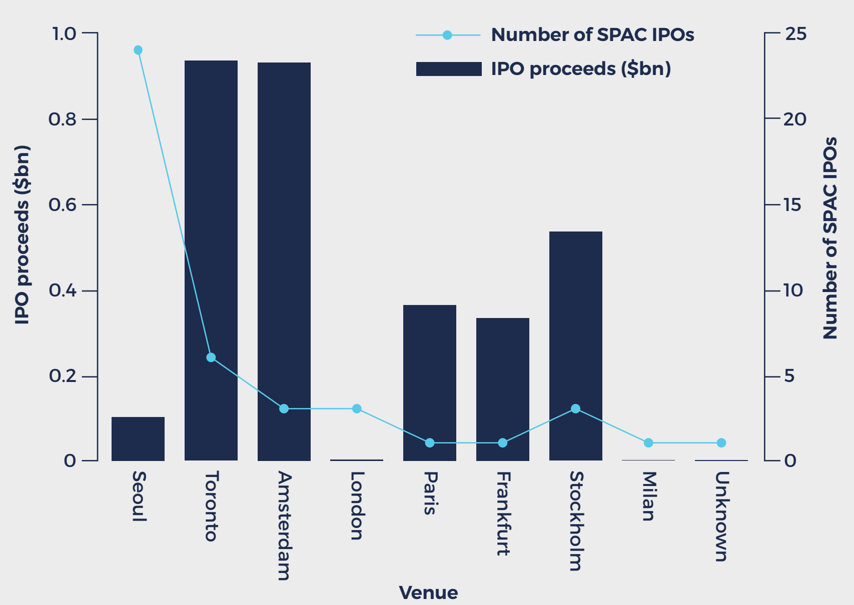
Countries compete with the United States for listings

As US SPACs scour the world for targets, other countries are scrambling to compete with New York as a venue for SPAC flotations. There is now investor interest in SPAC IPOs in London, given that Lord Hill's recent recommendations for the reform of UK listing rules could be implemented later this year. (The new rules would mean SPACs would not potentially have trading in their shares suspended when an acquisition is announced.) A number of SPACs have listed in Amsterdam, with more reportedly on the way. Frankfurt, too, is looking to gain a foothold, with German venture capitalist Klaus Hommels working with Deutsche Börse to develop a competitive SPAC structure that he hopes will allow European companies to retain their identity and local investors to benefit from domestic innovation. (We compare the basic features of SPACs listed in Amsterdam, Frankfurt and London with their US equivalents [here](#).) Similar discussions are under way in Asia, where Indonesia's stock exchange recently announced it was following Seoul's KOSDAQ, Hong Kong and Singapore in considering whether to allow SPAC IPOs.

US SPAC deals for overseas assets, 2000–2021



Non-US SPAC IPOs, 2020–2021



Source: Refinitiv. Data correct to 03/24/2021

The GameStop effect

> The "Reddit army" have sent shares in AMC Cinemas soaring, so much so that Silver Lake has swapped $600m of AMC convertible bonds for equity.

GameStop's stock has been caught in a "short squeeze" driven by retail investors.

Does the GameStop phenomenon – the chatboard-driven battle between retail investors and short sellers – have an M&A angle?

If a fund is shorting a company's stock it's because the shares are perceived to be overvalued, which in turn may be a sign of an underlying issue with the business (or that the stock has simply traded too high). If the bet proves right and the shares start to fall, it can be a trigger for activists to come in and potentially push for a sale.

Some companies try to fight back against short sellers by soliciting takeover bids (as was the case with Concordia Healthcare a few years back). Such tactics threaten the short sellers' position (if an offer, or rumors of one, pushes the shares up), but also present risks for potential bidders (if the short sellers' thesis wins out).

However, if, like GameStop, the company's stock soars after being caught in a "short squeeze," it makes any deal extremely unlikely. Instead, the company (assuming the capital markets will support further equity fundraising) can use its newfound valuation to tap public investors to raise cash, buying time for its management team to execute that turnaround/repositioning/portfolio optimization. While it could, in theory, use its stock as M&A currency, that would typically require a longer open window (for deal talks and proxy/prospectus review periods) than an equity issuance for a public company. It also requires the target's board to believe the buyer's higher valuation.

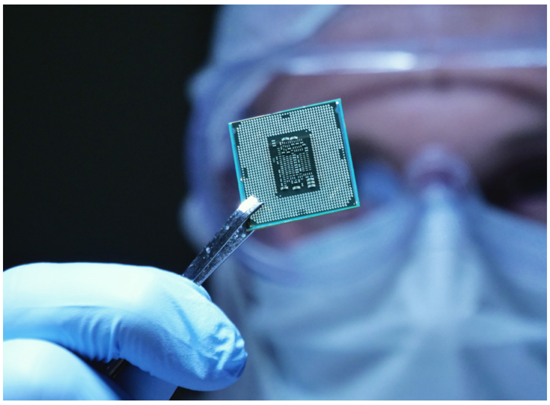
There are other consequences for the company's balance sheet – the "Reddit army" have sent shares in AMC Cinemas soaring, so much so that Silver Lake has swapped $600m of AMC convertible bonds for equity, wiping out a huge chunk of its debt at a stroke.

As far as GameStop itself is concerned, there is speculation the company's board (recently refreshed following a fierce proxy battle) can transform its fortunes, potentially by pivoting towards a new model built around social gaming rather than sales of physical products. At points over recent months, GameStop's market cap has been so high it would have entered the S&P 500 had it had a net-positive income. If it gets there, ETFs and other index funds will be obliged to buy in whatever the price, providing some insulation from the stock falling back to its pre-squeeze levels. And if the equity remains elevated, it could provide GameStop with the financial power to execute its own transformation.

China, sanctions and cross-border investment

Before the recent escalation of the sanctions row between China and the West, there were rumors of Chinese companies eyeing European tech companies after a relatively quiet period for inbound deals.

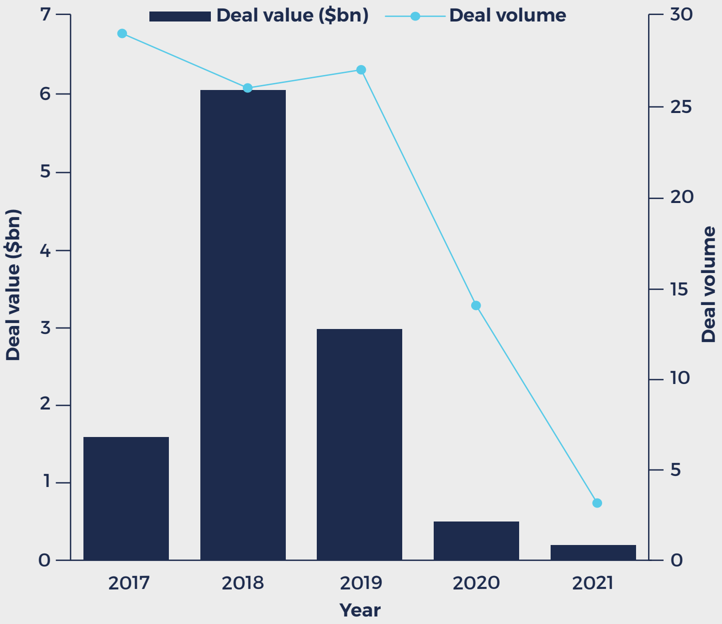
Their renewed interest followed the conclusion of talks late last year over the EU/China investment agreement, the ratification of which (according to EU trade commissioner Valdis Dombrovskis) now hinges on how the diplomatic dispute between Brussels and Beijing unfolds. If the deal is approved – by no means certain following China's imposition of sanctions on members of the European Parliament – there is nothing in it that stops member states using their existing powers to block prospective Chinese investments on national interest grounds. But given the delicate diplomatic situation, it will be interesting to see what impact future decisions of this kind will have on general trade relations between the two sides. If you're interested in reading about the fast-evolving world of foreign investment regulations, we're launching a quarterly Foreign Investment monitor dedicated to the topic in a few weeks' time.



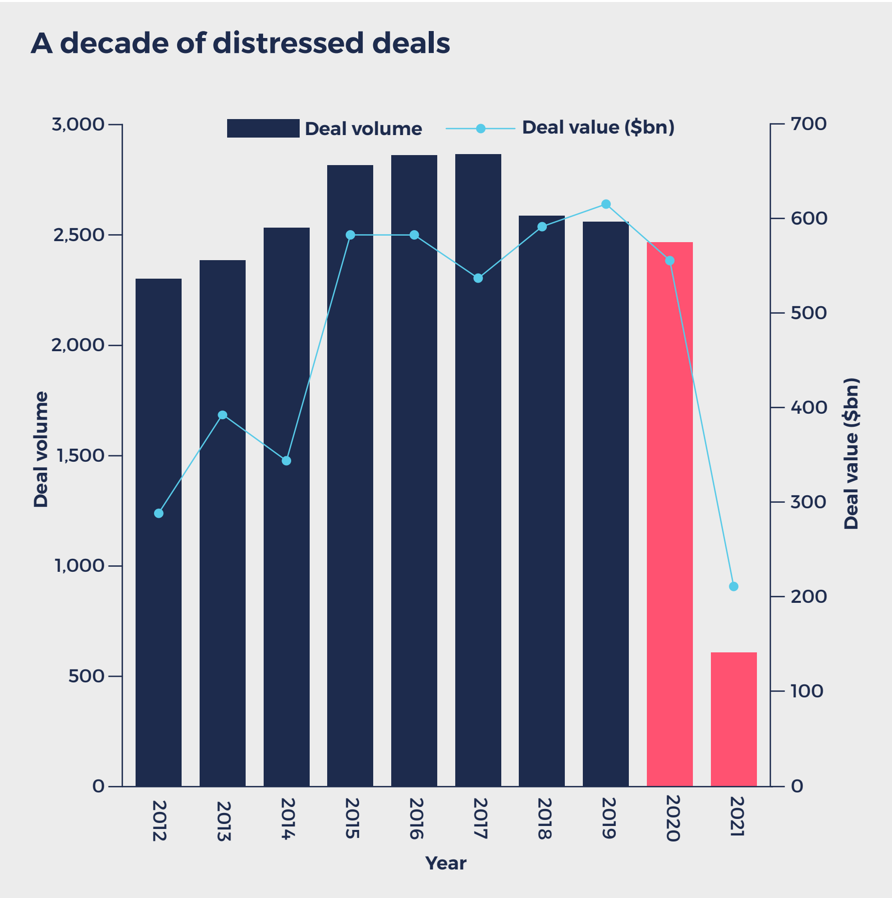
Chinese investment in European tech has dropped dramatically since its peak in 2018.

> “If the deal is approved, there is nothing in it that stops member states using their existing powers to block prospective Chinese investments on national interest grounds.

Chinese acquisitions of European tech companies



Where have all the distressed deals gone?



It would have been logical to expect the pandemic to drive a wave of distressed deals, but looking at data for transactions involving targets or sellers with debt-to-earnings ratios greater than six – or with non-investment grade debt – so far they've failed to materialize.

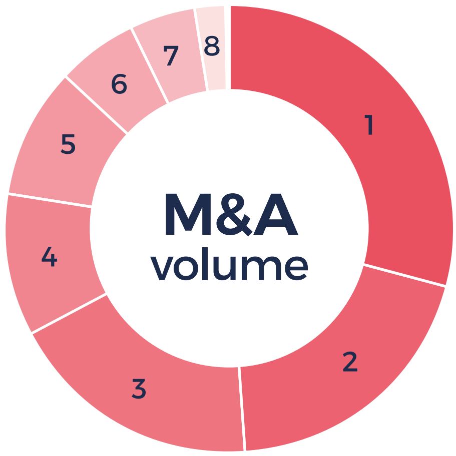
This may be because buyers don't want to own the assets until there's more clarity over the shape of the recovery. So as restrictions are gradually eased and government financial support is reduced, we may see an uptick later in the year.

COVID-19 has not seen distressed M&A rise – for now.

Global M&A Q1 2021, activity by sector

Sector	Value $bn	%
1 TMT	346.8	31.14
2 Financials	178.0	15.98
3 Industrials and materials	155.1	13.92
4 Energy and power	134.0	12.03
5 Healthcare	108.7	9.76
6 Consumer*	95.7	8.60
7 Infrastructure and transport	50.3	4.52
8 Real estate	45.1	4.05
Total	**1,113.8**	**100**

* Includes retail



Sector	Volume	%
1 TMT	3,128	29.24
2 Consumer*	2,114	19.76
3 Industrials and materials	1,974	18.45
4 Financials	1,091	10.20
5 Healthcare	1,006	9.40
6 Energy and power	640	5.98
7 Real estate	500	4.67
8 Infrastructure and transport	244	2.28
Total	**10,697**	**100**

* Includes retail

Source: Refinitiv (data correct to 03/24/2021)

Global M&A Q1 2021 – value and volume

	Global*	USA*†	Europe*†	Asia-Pacific*†
M&A value	$1,113.8bn	$610bn	$210bn	$166bn
M&A deal volume	10,697	2,708	3,351	3,398

Top 3 deals

	Global		USA		Europe		Asia-Pacific	
1	GE Capital Aviation Services/AerCap Holdings	$31.2bn	GE Capital Aviation Services/AerCap Holdings	$31.2bn	PPL WPD Investments/National Grid Holdings One	$20.1bn	Crown Resorts/ Blackstone Group	$6.2bn
2	Kansas City Southern/ Canadian Pacific Railway	$28.7bn	Kansas City Southern/ Canadian Pacific Railway	$28.7bn	Suez – French businesses/Investor group comprising Ardian and Global Infrastructure Partners	$14.2bn	Dewan Housing Finance Corp/Piramal Capital and Housing Finance	$4.7bn
3	The Hartford Financial Services Group/Chubb	$23.4bn	The Hartford Financial Services Group/Chubb	$23.4bn	Ardagh Metal Packaging/Gores Holdings V	$9.5bn	Renew Power Pvt Ltd/RMG Acquisition Corp II	$3.6bn

Inbound

Global – most targeted markets		USA – markets investing into US companies		Europe – markets investing into European companies		Asia-Pacific – markets investing into Asia-Pacific companies	
US 2,808 deals	$608bn	US 2,220 deals	$486bn	US 336 deals	$63bn	China 1,314 deals	$76bn
Canada 363 deals	$88bn	Ireland 14 deals	$49bn	UK 695 deals	$42bn	US 105 deals	$17bn
China 1,343 deals	$77bn	Canada 77 deals	$34bn	France 315 deals	$15bn	Hong Kong 129 deals	$13bn

Outbound

Global – most acquisitive markets		USA – markets US companies are investing into		Europe – markets European companies are investing into		Asia-Pacific – markets Asia-Pacific companies are investing into	
US 2,708 deals	$610bn	US 2,220	$486bn	US 161 deals	$69bn	China 1,340 deals	$73bn
China 1,385 deals	$76bn	Israel 23 deals	$26bn	UK 662 deals	$44bn	Japan 655 deals	$14bn
UK 909 deals	$74bn	UK 140 deals	$17bn	France 281 deals	$23bn	US 64 deals	$14bn

Financial sponsor M&A – top 3 deals with buyside financial sponsor involvement

1. **$14.2bn** – Suez – French businesses/ Investor group comprising Ardian and Global Infrastructure Partners
2. **$9.4bn** – Telxius Telecom – Telecommunications Towers Division Europe/ American Tower
3. **$7.8bn** – Athene Holding/ Apollo Global Management

* Deal value includes net debt of target | † Includes domestic deals | Source: Refinitiv | Data correct to 03/24/2021