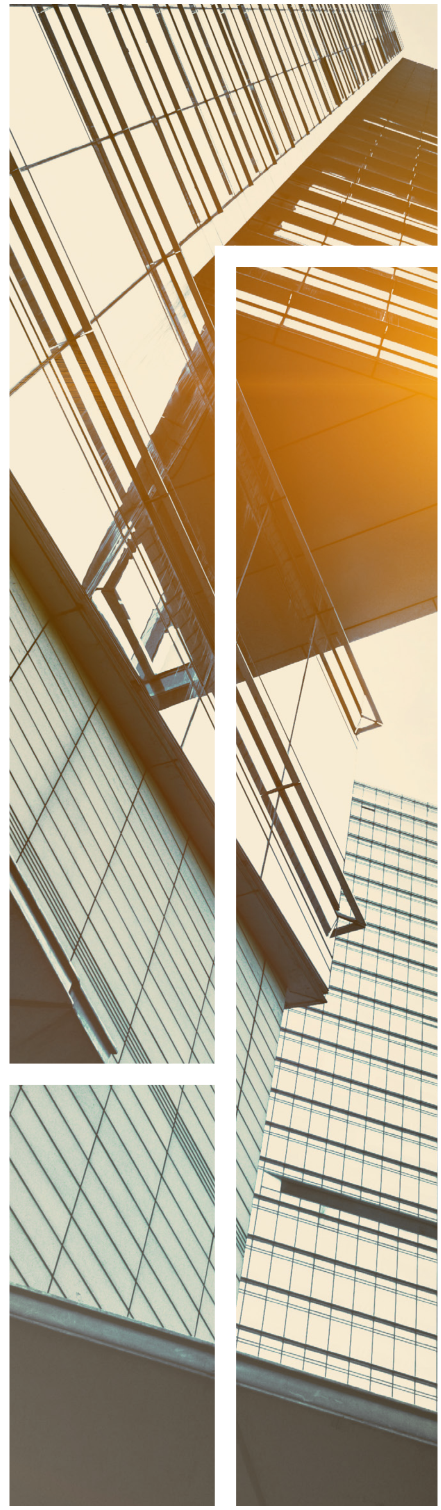
UK Dealmaking Outlook: Six Trends Underpinning M&A in 2022



Mergers and acquisitions (M&A) activity reached an all-time high in 2021, eclipsing prior records by $1 trillion. This was fueled by an abundance of investment capital, revamped corporate strategies and private equity investors again at the forefront of deal activity. The technology sector took center stage, as companies across industries continued to navigate digital disruption and increasing pressure from stakeholders to unlock value in their companies and portfolios.

Many drivers of the M&A activity over the past year have even further to run, and companies across sectors continue to seek scale and focus while repositioning themselves to capture growth. The imperatives for deal making — including digital transformation — have strengthened, and the supply of capital, not least from private equity and SPACs, is plentiful. Lincoln recently conducted a survey of nearly 400 global private equity investors, confirming that deploying capital remains a top priority in 2022.

This, however, is not to downplay the significant risks the market still faces. Uncertainty related to the conflict in Ukraine and ongoing geopolitical events may dampen dealmaking, particularly in Europe. Questions around potential exposure to Russia as well as general market sentiment could impact investor appetite for M&A. In parallel, increased regulatory scrutiny, alongside the rising cost of energy, supply chain challenges and inflation remaining at multi-year highs are all likely to create some headwinds. Corporates as well as investors face additional challenges from lofty valuations, the war for talent, deal complexity and fierce competition for high-quality assets.

Hot sectors from 2021 remain attractive in 2022

Technology. The investment case for technology remains strong as digital consumption and connectivity continue to intensify. Companies within the industry are consolidating, converging, and acquiring technological capabilities; outside acquirers are looking at businesses in the sector for their transformative potential. Areas of particular focus include cybersecurity and supply chain technology, both likely to increase in importance as the conflict in Ukraine unfolds.

Healthcare. M&A activity and valuations in healthcare remain high with no signs of a slowdown in 2022. We expect pharmaceuticals, life sciences and healthcare services to draw significant interest from both investors and strategic players, led by innovations in biotechnology and patient services.

Distribution. We saw a lot of activity in the distribution space in 2021 and expect momentum to continue over the next few years, primarily driven by the need to improve and build resilience into supply chains.

Energy. The green transition will drive an acceleration of investment in renewables, energy efficiency and clean energy solutions as regulation and increasing pressure from stakeholders drive businesses to pivot away from carbon-intensive assets.

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Deal momentum underpinned by key M&A trends and drivers

Strategic need for innovation, technology and growth. Businesses have focused on the digital transformation of their operations over the past several years. Catalyzed by the pandemic outbreak, the speed and scale of the change has significantly increased. Lincoln expects the strategic shift to digital, innovative and disruptive models to continue be an important driver of deals across sectors, as businesses are seeking new ways to grow revenue, increase efficiencies and futureproof their operations.

The era of the pivot. From local independent businesses to large global enterprises, companies that have successfully navigated the COVID-19 pandemic have often pivoted to a business model that is conducive to short-term survival, long-term resilience and growth. Increasingly, traditional companies are pursuing transformative deals to reposition themselves in the new post-pandemic paradigm and align their portfolios to long-term trends.

Divestitures to unlock value. Corporate carve-outs and divestitures were an increasingly important factor in 2021 and will continue to be in 2022 as companies look to unlock value, simplify portfolios and strengthen balance sheets. Companies realize the value of being nimble, with the ability to quickly react to an ever-changing environment and potential disruption. In some sectors, the desire for greater financial and operational agility now appears to outweigh the traditional benefits of scale and conglomeration. This fundamental reorientation can, to some extent, be attributed to the resurgence of shareholder activism but should primarily be seen as a product of a world changing at break-neck speed.

Resilient and optimized supply chains. Companies continue to leverage M&A to build agility and resilience against prevailing headwinds. Since the COVID-19 pandemic exposed the many vulnerabilities of global supply chains and third-party vendor ecosystems, companies are increasingly shoring up their supply chains to reduce lead times and build greater resilience. We expect onshoring, nearshoring and vertical integration – both upwards, to secure key raw materials or components, and downwards, to control how products are distributed – to drive deal activity in 2022 and beyond, particularly in the manufacturing, pharmaceutical and medical devices sectors. In addition, we see growing interest in supply chain security and risk management and in process optimization – especially data-driven, AI-powered and automated solutions.

Rising impact of ESG as a value and deal driver. The ESG agenda, now climbing toward the top of private company strategies and M&A decision-making, may generate significant deal activity going forward as businesses pivot to improve their environmental footprint and invest in technology and innovative solutions to help accelerate the shift to a sustainable, circular economy. ESG is no longer a fringe concern and will only continue to grow in importance. Environmental, social and governance factors are integrating into business models across sectors; ESG driven M&A is an important means to create growth, gain competitive edge and is key in establishing stakeholder trust.

ESG is increasingly regarded as a key lever of value and return, and a strong profile opens access to capital, at more favorable terms, as ESG considerations gain more influence on capital allocation decisions and credit ratings.

Sponsors and SPACs putting capital to work. Corporate cash remains at record levels; debt financing is cheap and readily available (for now). Private equity firms were a major driver of the deal flow in 2021 and will likely continue to gain share. They have replenished their coffers through a torrid fundraising spree, they continue to have record levels of dry powder to deploy and in some cases, they have an advantage over strategics in the current tougher antitrust environment. Even though the popularity of SPACs has faltered, about a quarter of SPAC capital is set to expire at the end of 2022 which will likely add billions to dealmaking across a range of sectors.

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