
THE M&A LANDSCAPE IN THE ERA OF COVID-19

# Examining the impact of US elections on cyclicality in dealmaking

*Data provided by* PitchBook

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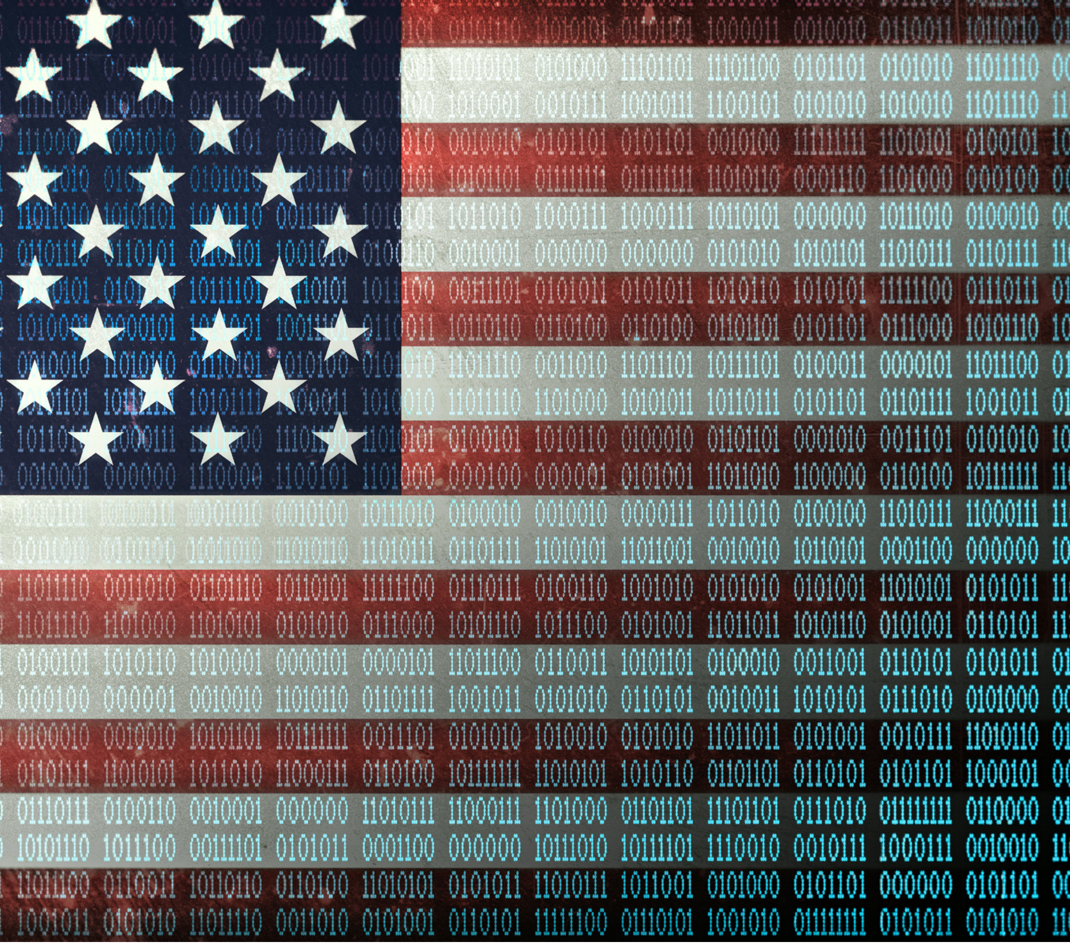


# Contents



# Executive summary

When we set out to prepare a whitepaper unpacking the impacts of election cycles on dealmaking trends in the United States, the major domestic stock indices still had record heights to hit. That was little more than a month ago. The thread that ties the present moment to past elections in the datasets examined below is volatility. Markets hate volatility. End of story. They don't like the unknown and, at the time of publication, COVID-19 has created levels of volatility we haven't seen for a long time, and looks likely to alter markets for the foreseeable future. But the past also serves as an instructive guide.

A number of presidential elections have accompanied some truly trying times, as recessions have coincided with more than just the 2008 cycle. Fallout from the bursting of the dot-com bubble rippled through the 2000 cycle, while the recession that ended in 1991 is often cited as factoring into George H.W. Bush's reelection defeat in 1992. To get a deal done can take a lot longer in such periods of elevated uncertainty, as the due diligence process can expand by an additional quarter, sometimes more. What appears clear from the data we examine below is that these periods of elevated uncertainty, rather than the runup to elections, have precipitated pullbacks in dealmaking from the start of 2006.

To pause for a moment with one illustrative datapoint, heading into the 2008 election, M&A activity in the US would remain strong, with annual figures matching those of 2006 in overall value on 2,500 more transactions. This finding demonstrates that aggregate M&A figures represent lagging indicators of market sentiment, among other things, as M&A would not hit bottom until 2009, when the worst of the financial crisis had passed in the US. Likewise, PE deals in the US would hit heights for aggregate value during the 2008 election cycle untouched in the years since—hardly a paucity in buyout activity.

What matters far more to markets and dealmakers are the policy moves made following an election. Such effects turn up in the data, bearing out another trend explored in greater depth below: There's discernible variation in policy impact by subsector and transaction type. PE exhibits an impact, particularly on deal values. M&A activity in the US manufacturing sector heading into this election cycle, for example, had already started to wind down over successive quarters as the picture around global trade became less certain, disrupting supply chains coming out of Asia. In short, elections are a clear focal point, but the policies that emerge once the dust has settled matter more in dealmaking, particularly for how markets emerge from concurrent crises like that witnessed in 2008.

**CRAIG CLAY**
**PRESIDENT OF GLOBAL CAPITAL MARKETS, DFIN**

# Industry developments

### $200M

Combined size of fines levied by the US Federal Communications Commission against the principle wireless carriers for selling customer location data without adequately guarding against unauthorized access

### $2.4T

The amount of dry powder ready to hand across private investment vehicles, limited not only to private equity and venture capital funds, but also an array of strategies including real assets, debt, funds of funds and secondaries

### 11%

The rate at which US merchandise exports to China fell last year, which totaled about $107 billion for 2019, according to the US Commerce Department, with Texas, Florida and Alabama each declining by more than 25%

### 70%

Share of CEOs, CFOs and COOs coming into the current US election cycle "very actively" looking for opportunities to help direct data privacy policy, according to a PwC survey, with trade, healthcare and workforce following close behind

### Denominator effect

The increase of an investment portfolio's allocations to private equity, the "numerator," relative to the deterioration of its positions in the public markets, the "denominator," which can force a rebalancing by exiting fund holdings

### $88.5B

The anticipated size of the global enterprise governance, risk and compliance market by 2027, representing a compound annual growth rate of some 14%, according to Grand View Research

# Q&A

## Craig Clay

**President of Global Capital Markets, DFIN**

Prior to his current role, Craig served as senior vice president at R.R. Donnelley leading the Global Capital Markets and Legal Process Outsourcing business. Before joining the company, Craig was a leading financial analyst at American Eurocopter, a subsidiary of Aerospatiale.

Craig received a Bachelor of Business Administration from Baylor University and earned a Master of Business Administration from Southern Methodist University. Craig serves as a trustee for Big Brothers Big Sisters of New York City and is a board member for Guardum, LLC, the leading data privacy provider.

**COVID-19 has already radically affected markets and policy discussions going forward. As we grapple with the fallout, what security measures should clients be thinking about knowing that "shelter in place" means "working from home"?**

Protect your devices and data, just like you would in the workplace. Some reminders include keeping in close contact with your IT department and using what is in their toolbox. Stay current on software updates and keep VPN on at all times. Lastly, beware of COVID-19-themed phishing emails. Bad actors are taking advantage of the crisis. The best solution for sharing business-critical documents is to use a virtual data room. Utilizing a collaborative online platform is more crucial than ever when access to in-person meetings is prohibited. VDRs are not just for deals. Today, they are critical for internal collaboration that delivers bank-grade security while providing time-saving benefits using AI.

**Data privacy has overtaken antitrust and drug pricing, among other policy areas. What explains the rise of data as a presiding concern in the C-Suite, and which shifts in the market around data privacy do you anticipate this cycle will shape?**

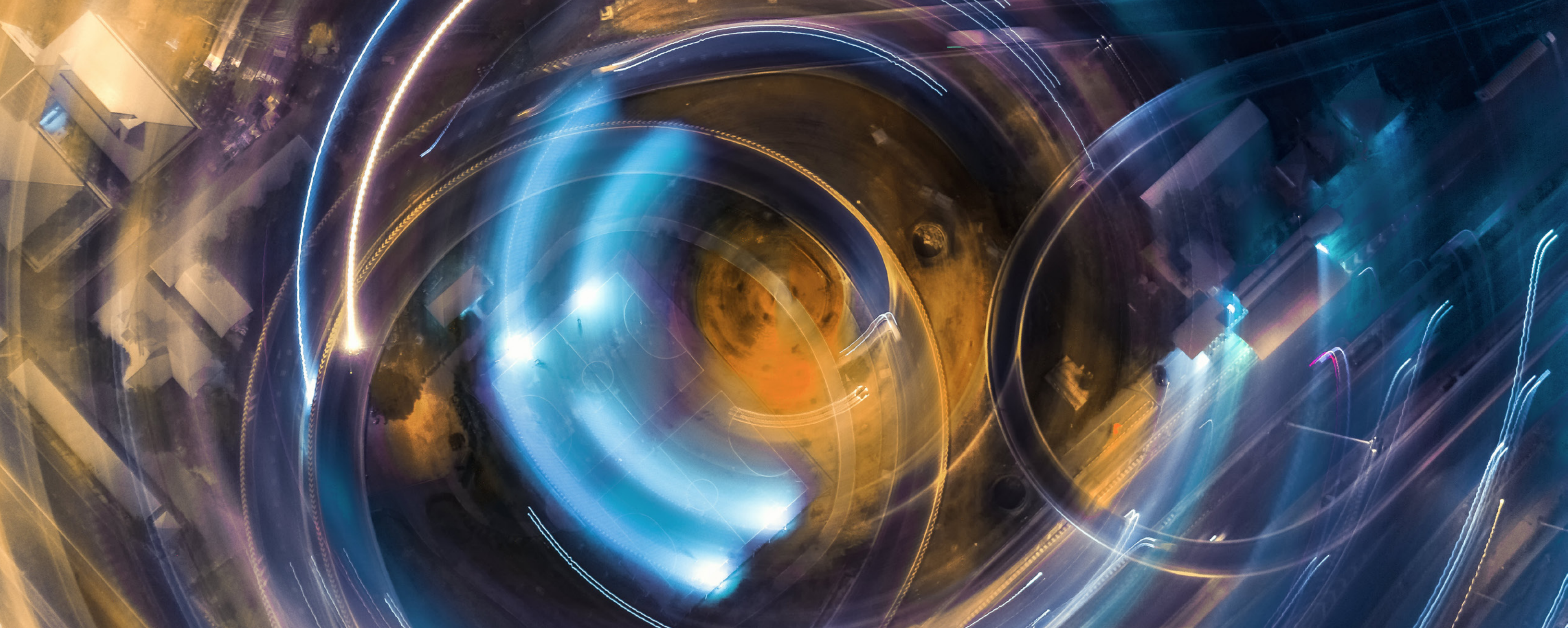
Two things have been playing out heading into this cycle. The first is data privacy, and then there's the separate but related set of concerns around cybersecurity. Particularly for the general public, data privacy has become top of mind as we all come to understand more about the sheer amount of data on us that platforms such as Facebook and Google collect with each passing day. These concerns have already informed policy moves as witnessed with the implementation of GDPR across the EU in 2018 and the California Consumer Privacy Act coming online at the start of this year. These policies have brought data privacy compliance squarely into the purview of the C-Suite on a level comparable to extant concerns around ensuring the security of the digital assets and IT infrastructure of the enterprise.

In addition, the FTC released its new position on data security at the beginning of the year, giving companies a clearer understanding of the FTC's expectations for security practices. The new orders emphasized the role of executives in taking responsibility for overseeing policy in the hopes that C-Suite and board-level buy-in will improve compliance. Under the new orders, companies must present their board with an annual report on their security program, and senior officers must directly provide the FTC with certifications of compliance in hopes this will force senior managers to gather detailed information about the company's information security program, so they can personally corroborate compliance with an order's key provisions each year.

But the emerging picture of data privacy as a complementary concern to cybersecurity could become a lot more complex with the spread of COVID-19. In coordination with leaders in health and tech, federal officials have discussed aggregating and anonymizing user data to track user location in order to monitor the spread of COVID-19. These moves not only represent a complicated balancing act around data privacy and the public good, but also take place against the patchwork of state policies and a much older privacy regime in HIPAA that outlines the lawful use of health information. How this situation is resolved could very well inform data privacy standards for the foreseeable future, representing a natural extension of the ongoing policy conversation around the federal government stepping up to unite state-by-state data privacy regulations. As a result, I would expect to see consolidation in the data privacy market as sizable enterprises try to acquire smaller, more nimble players with more advanced technologies that could solve one-off problems. Big companies often focus on the security of their large networks. So, I anticipate an uptick in the strategic acquisition of compliance solutions providers as incumbents look to expand existing platforms.

**With that in mind, what additional benefits to the safety, security and accessibility of data do you expect from the expanded deployment of AI and machine learning in financial services?**

In just a few short years, AI and machine learning have become tools necessary to improve productivity and build a company's value chain. AI deployed to service a host of clients, ranging from law firms and advisers to corporates and private equity, in a secure data room has



improved the quality and efficiency of engagements across each phase of the transaction. With the recent mandates surrounding COVID-19 regarding minimizing movement and physical contact, most professionals are working from home. VDRs and AI are even more pressing and vital to the productivity, security and efficiency for transactions to move forward during this pandemic. In addition to security and accessibility of VDRs, there are skills AI & ML can be trained to do from the moment users begin to use the platform, including facilitating tasks like contract review. The eBrevia contract reviewer, for example, learns from behaviors around specific clauses, say, and in relatively short order starts to become very specific in how it operates per the accounting or law firm using it. From our vantage point, these tools add tremendous value for our clients because they make it easier for people to do their jobs, leverage their ability to focus on higher level analytics and input to provide their own clients with better insight. It is also crucial during times like these, where the human workforce may not be at full working capacity and these tools can fill the gaps.

**With so much talk of antitrust examinations, do you anticipate any divestitures by any companies or spinouts, or is that too premature?**

That still seems premature, particularly as the markets continue to grapple with the impacts of COVID-19. Rather, I suspect that the lure of innovation will continue to drive people to leave positions at tech giants and other companies to start things where they can move more quickly or get funding for more targeted innovations. I return to the security side as an example. A single tool, perhaps one that's very much needed to address a certain compliance or regulatory framework, can come to market, prompting someone to say, "We're going to buy that, because why build it in-house when this is quicker and faster?" The need for speed and agility is no less at a premium today, and I anticipate that need should continue to inform exit and acqui-hire activity going forward. Organic growth may take a back burner to inorganic.

**What's shaping up this election cycle that stands out from your experience?**

A number of the most recent presidential elections have coincided with some truly trying times—and by no means just for markets. This election cycle is no exception. The election in 2000 coincided with the dot-com bubble bursting, sending stock markets plummeting. Flash forward to 2008, that election took place in the some of the darkest days in living memory. When a market's down by historic margins, that's certainly not an election cycle issue. That's a macroeconomic issue. It's tough to say what the future holds, but this election cycle may register in the data in a similar manner. All the same, you can see some correlation in the numbers between a policy or regulation coming online and its impact on dealmaking. In the years since the JOBS Act encouraged small businesses to become public companies, the SEC has made the filing process easier to manage with the support of smaller regulations like the FAST Act, adopted a year ago, to simplify certain disclosure requirements in Regulation S-K, including incorporation by reference.

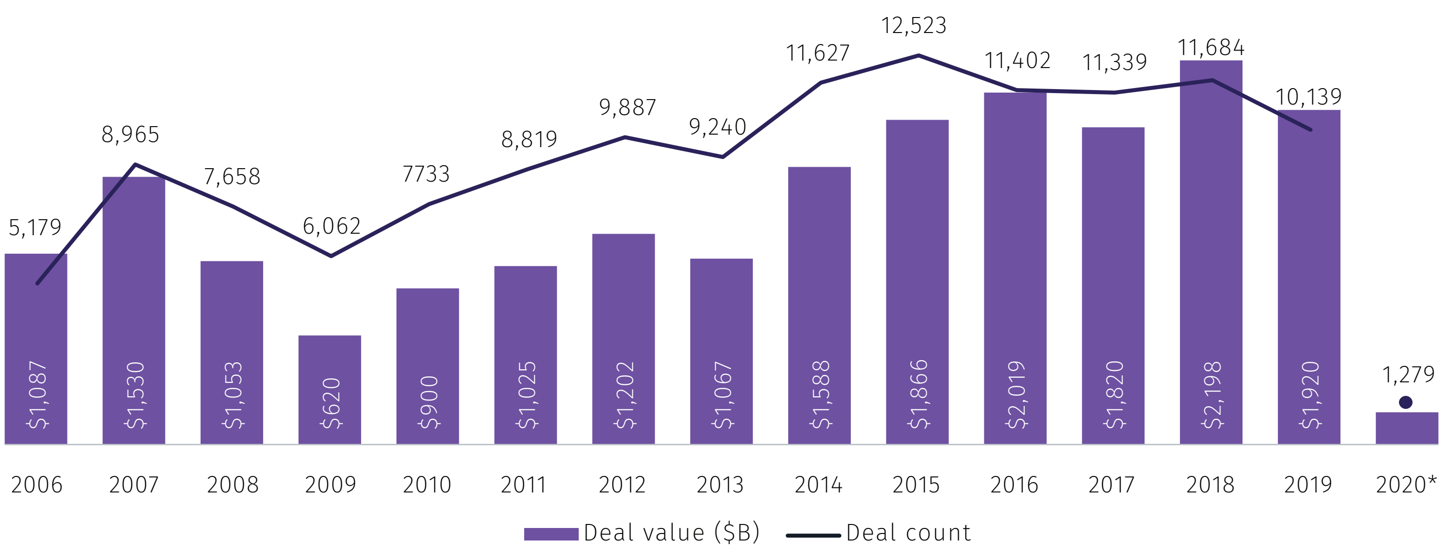
In the future, I anticipate technology to continue evolving alongside the regulatory ecosystem around direct listings. That's not a near-term bet, though, as there's no underwritten issuance of shares in a direct listing, which can cause a lot of unwanted volatility without the stabilization effort and price management regime that investment banks provide. SPACs are also viable paths for companies exploring growth funding and liquidity outside of a traditional public offering and with close to 90 SPACs looking for acquisitions, this will certainly remain a viable option.

But these are unpredictable times. While this year is unlike any other, our global economy will recover. It always has. Through it all, we're reminded that technology connects us like never before. This connectivity will continue to change the way we work, while yielding enormous productivity benefits for those firms that are well-positioned. Further, it's likely safe to say that organizations that are at the forefront of ESG practices will lead the way by demonstrating how to maximize the intersection of technology and regulation, with the patience, understanding and compassion necessary to adapt in an ever-changing landscape.

I wish all companies well through this crisis. Together, we will get through it.

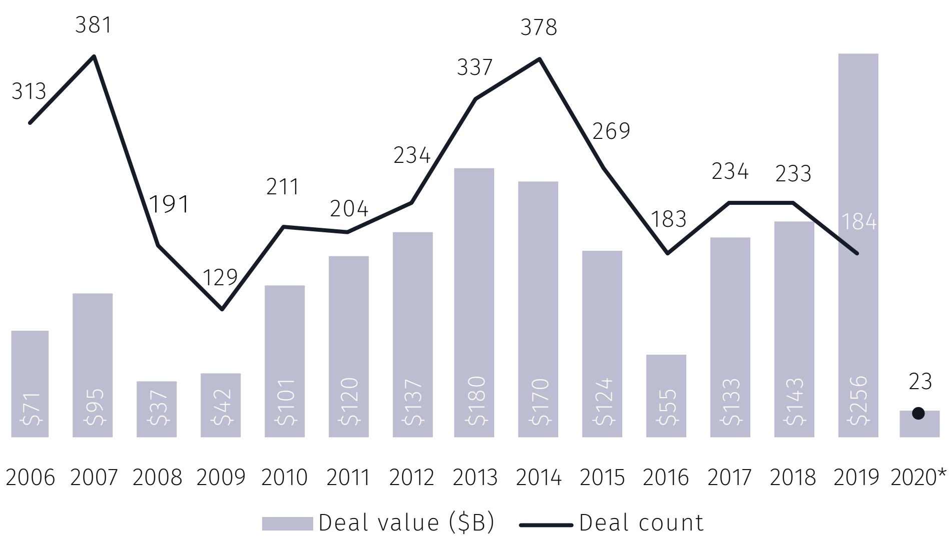
# The M&A landscape

US M&A activity




Source: PitchBook
*As of March 1, 2020

US IPO activity




Source: PitchBook
*As of March 1, 2020

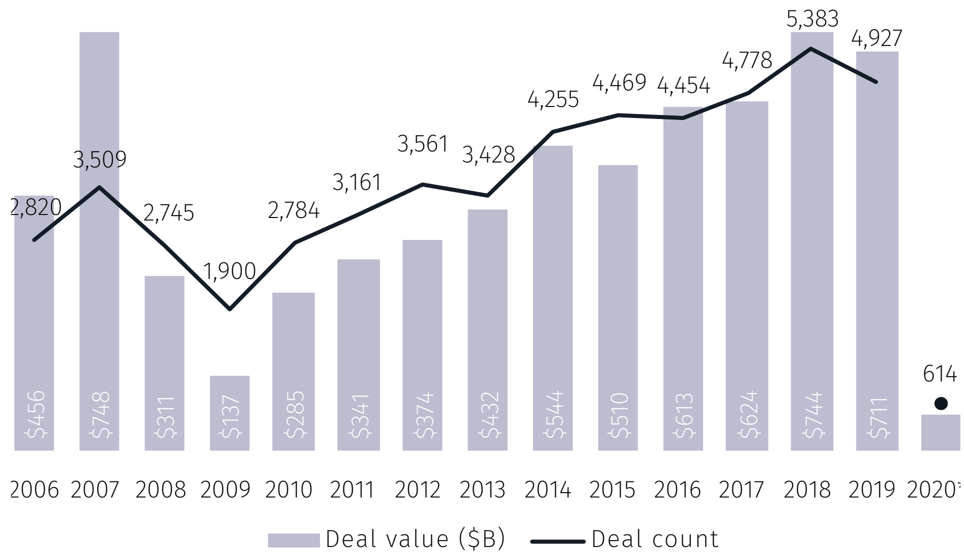
## 53%

The decline in the number of PE-backed exits between 2007 and 2009, representing a drop of 62% in aggregate value

$444.2B

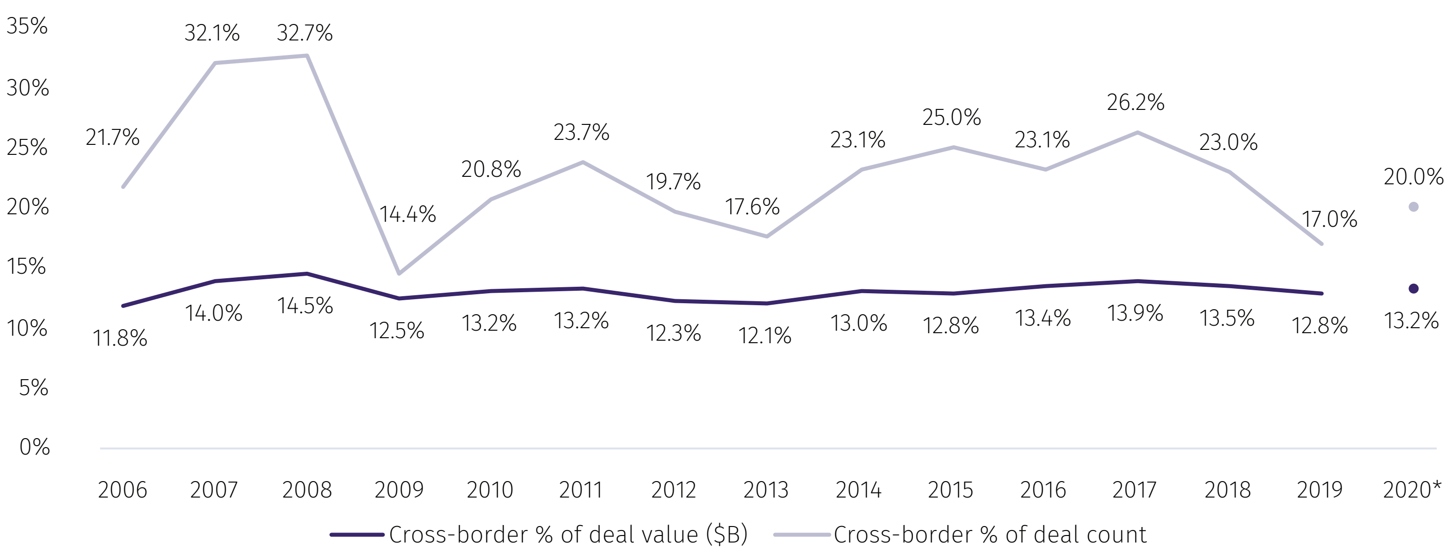
The value of cross-border M&A in 2016 across 1,317 completed transactions, activity which fell to $307.4 billion on 1,124 deals in 2019

US PE deal activity




Source: PitchBook
*As of March 1, 2020

Cross-border % of US M&A

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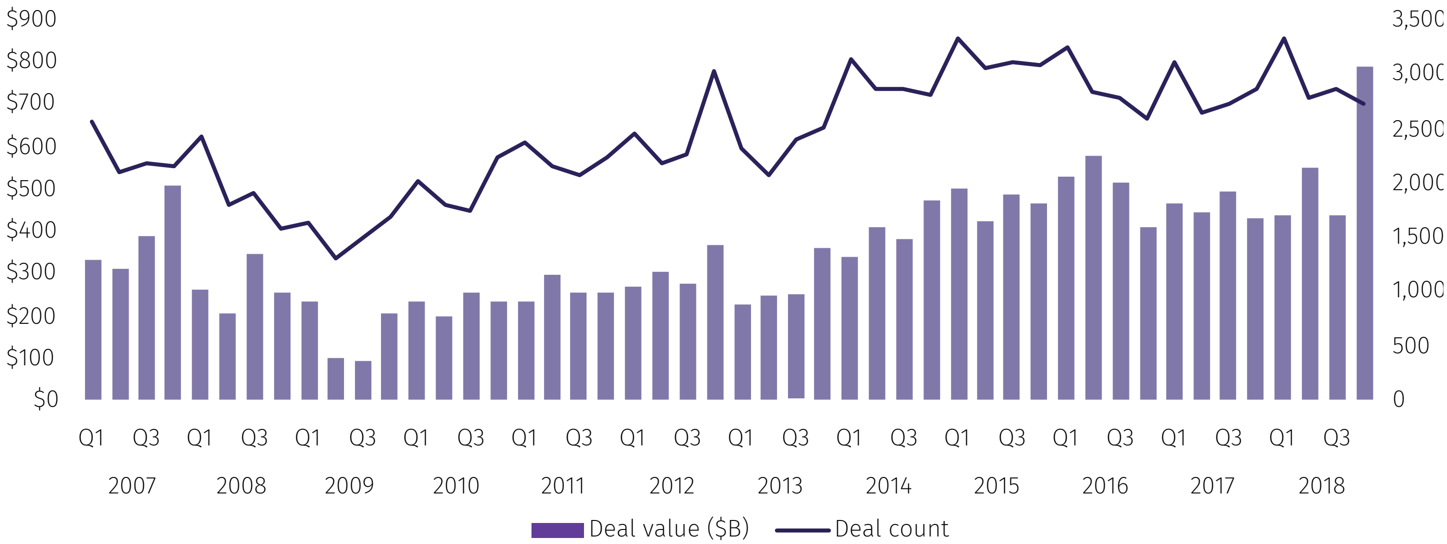
# Dealmaking landscape

US M&A activity ($B) by quarter




Source: PitchBook

M&A activity has a cyclical nature—so does the democratic process. Because successive waves of M&A have risen down the decades in response to different underlying forces, some quite apart from those informing contemporary electoral politics, such as the emergence of new technologies, regulatory policy changes represent the area of greatest impact on the cyclicality of dealmaking in the US. With the current M&A cycle winding down alongside the rapid unravelling of the longest bull market in history, it bears repeating that the dealmaking wave that crashed with the financial crisis got its start during a slump in 2003. And it too was international in flavor with a strong financial scope to it, as sponsors supported a considerable share of M&A overall and by sector—until they couldn't.

In the runup to the 2008 election, M&A activity in the US remained strong, with figures for the year matching those of 2006 in overall value on 2,500 more transactions. Even as the financial crisis took firmer grip and campaigning ramped up, M&A activity would outperform 2009. As a lagging indicator of market sentiment, dealmaking did not hit bottom until the worst of the financial crisis had passed sometime in the middle of that year.

At the height of the crisis in Q3 2008, its most dramatic event would take place: the collapse of Lehman Brothers. M&A activity for the quarter represented $345.6 billion in aggregate value on 1,909 deals—a transaction count not topped until Q1 2010. Indeed, the results for the quarter running up to the 2008 election compare favorably to those registered across 2007. Likewise, PE deal value in the US hit a height in aggregate for the year leading into the 2008 election cycle that has gone untouched since.

All the same, the financial crisis brought the M&A cycle that started in 2003 to an end—not the election process that would play out alongside it. Moreover, a pair of massive relief packages, the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, the first enacted by the outgoing administration, the other adopted during the first year of the new one, would spur a recovery in capital markets that not only helped companies adapt to adverse macro conditions in the near term, but would in time make way for the current M&A cycle to form by reducing the cost of capital to historic lows, bringing liquidity back into equity and bond markets.

In the wake of the first major election cycle following the financial crisis, M&A activity would begin mounting its recovery. From Q1 through Q3 2012, M&A activity comprised a combined $837.5 billion on 6,864 completed deals before peaking in Q4 ahead of a decline in Q2 that would prove the bottom at $241.3 billion on 2,049 transactions. The current cycle would begin in earnest the following quarter with a 17% uptick in completed deals. Taking a step back, not only does the dealmaking performance in the runup to the 2012 election compare favorably to the financial crisis period that coincided with the 2008 election at $802.6 billion on 6,087 deals, it tops activity for the same multiquarter period the year prior at $775.4 billion on 6,582 deals.

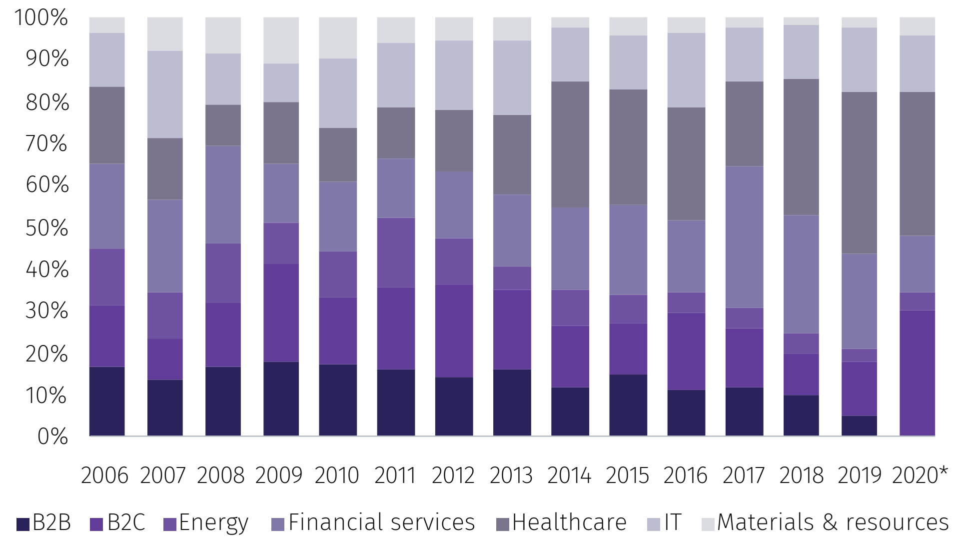
From mid-2013, an upward swing took hold, and, throughout 2014, M&A volumes increased rapidly. Improvements in the public markets over the same period would translate into loftier aggregate deal sizes as valuations increased and the cycle expanded. This dynamic was also fueled by strategic acquirers increasingly competing with financial sponsors sitting on record levels of dry powder. And of late, PE has kept the current cycle going, with sponsors grabbing a growing share of M&A volume. In 2015, PE secured 28.8% of M&A deals by count. Last year, that share grew to 40.2%. Meanwhile, VC-backed exits have also ridden the current M&A wave, with software leading the way followed by pharma & biotech. From 2013 through 2019, volume has met or exceeded some 900 completed transactions and at least some $70 billion in value over the same span. Thanks to a record year for VC-backed IPOs, 2019 posted an unprecedented $261 billion alone as a number of unicorns made their public debuts, even as the conditions for staying private remained as strong as ever. Last year, VC deals in the US reached a record 11,787 financing rounds comprising a near-record $136 billion in combined value.

Some of the conditions that took shape in the wake of the financial crisis that would spur the expansion of the current M&A cycle have also proven favorable to the growth in PE and VC dealmaking:

- Restructuring of the enterprise around developing regions
- Expanding the scope of business portfolios
- Optimizing for tax benefits and accessing cash held outside the US*

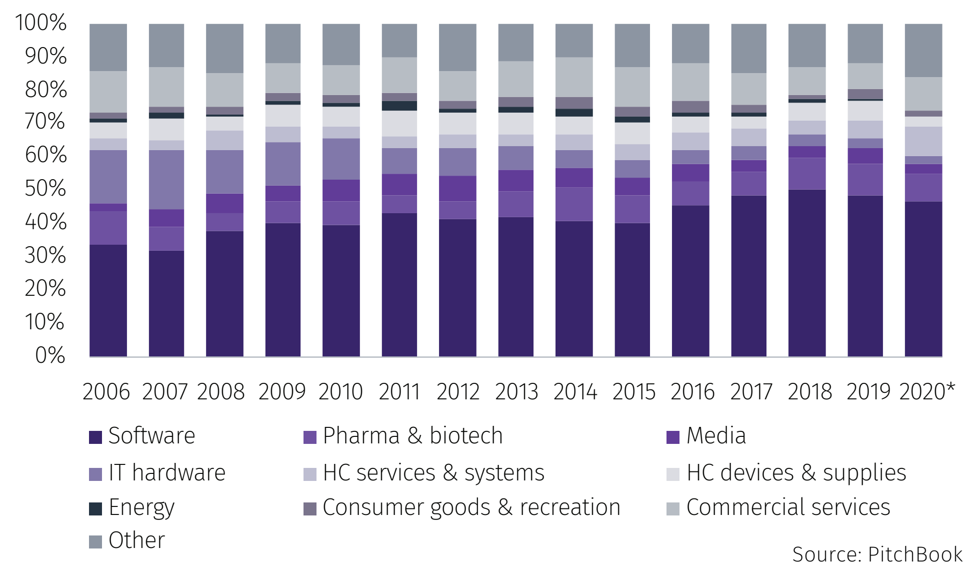
Although the view that tax inversions represented a kind of tax dodge would inform its emergence as a campaign issue during the 2014 midterm elections, it did little to derail dealmaking with the current cycle already well underway. Over the course of 2014, the number of completed transactions grew 26% YoY while deal value climbed by an additional $500 billion. The current cycle would reach its

US IPOs (#) by sector




Source: PitchBook
*As of March 1, 2020

US VC exits (#) by industry




Source: PitchBook
*As of March 1, 2020

*Adapted from "M&A activity: Where are we in the cycle?" Alternative Investment Analyst Review, Fabienne Cretin, Stéphane Dieudonné, Slimane Bouacha, Summer 2015, p. 43

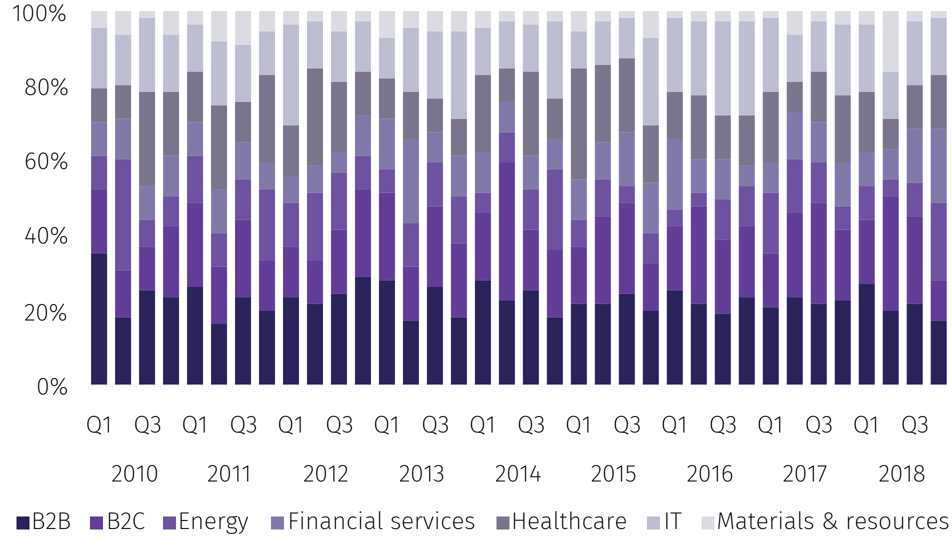
peak for completed transactions in 2015 at 12,523 comprising $1.9 trillion in value and, buoyed by PE's growing share of dealmaking since, annual volume has stayed above 11,000 transactions while value has hovered around $2 trillion for each of the past five years.

As the 2016 election approached, the momentum behind the cycle pushed M&A activity to its highest levels on a per quarter basis since at least 2006. From Q1 through Q3 2016, dealmakers completed 8,825 transactions worth a combined $1.6 trillion. Although activity decelerated into Q4, it popped to start 2017. However, the current cycle has proven less durable of late. Since the start of 2018, completed M&A has slid steadily, with Q4 2019 posting the lowest total since Q2 2013 as cross-border dealmaking has dried up. After reaching its highest share of M&A by deal count since the financial crisis at 26.2% in 2017, cross-border dealmaking in 2019 returned to levels last seen at the start of the current cycle at 17% in 2013.

"Coming into this election cycle and subsequent crisis, disruption to global supply chains out of Asia had already started really weighing negatively on dealmaking," says Craig Clay of DFIN. "But that's the result of policy, something from a dealmaking perspective you won't know the consequences of until six, seven months hence once it's been enacted."

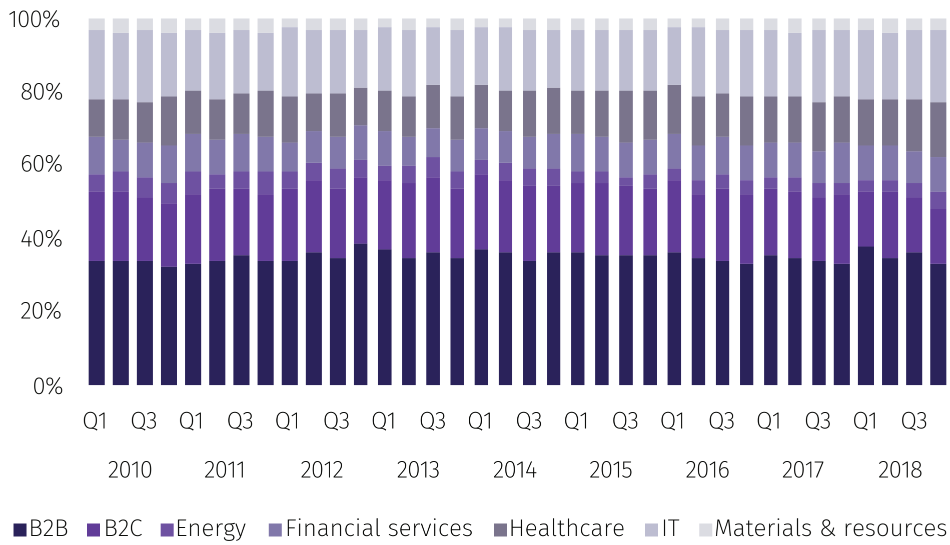
The marked slowdown in US growth from an exogenous shock like COVID-19 amid already hampered global trade will inevitably affect M&A activity over the quarters running up to the coming election. Although each M&A cycle unfolds in response to different material conditions confronting the enterprise, all have emerged during periods of economic recovery coupled with improvements in capital markets after successive quarters of underperformance.

US M&A ($) by sector




Source: PitchBook

US M&A (#) by sector

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