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Mergers and Acquisitions Trends for the Second Half of 2022

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By all accounts, 2021 was an unstoppable year for mergers and acquisitions, with over $5.1 trillion worth of transactions being completed. According to a KMPG study, over 60% of global M&A was U.S.-based, with a record-breaking $2.9 trillion in transactions being recorded. Cross-border transactions shattered records with $2.1 trillion in deals. While several megadeals boosted numbers, M&A volume significantly increased, in part, due to private equity and family office investment and new models of financing, specifically SPACs. An abundance of capital and lower interest rates fueled M&A projections for 2022 but the reality has been quite different.

According to Refinitiv, deal values declined by 21% compared to the first half of 2021, yet volume remained strong. Supply chain issues, inflation, the conflict in Ukraine, Russia's decision to halt gas supplies, rising interest rates, a volatile stock market and more have blended to create a tumultuous first half of the year for businesses looking to buy or sell. These economic fundamentals and headwinds have produced a multiplicative and layering effect that further places a strain on M&A dealmaking.

Historically, the M&A market flows in waves. Highs are followed by traditionally short-lasting lows. For example, the megadeals of the '90s that fettered out in scandals—think Enron—and the bursting of the dot-com bubble gave birth to shareholder activism and an influx of private equity.

Whether the M&A market is at the bottom of the wave or just slowing down is yet to be seen. However, areas of opportunity continue to exist, and corporate dealmakers and attorneys need to be prepared for them. Among the top trends we'll continue to see in the second half of 2022 are ESG (environmental, social, and corporate governance) deals, cross-border transactions, and complex recession-proof industry deals—top among them being Fintech, technology, energy, health care and telecommunications.

ESG is no longer a trendy concept, and it is now affecting and, at times, driving M&A activity. ESG has become a top priority for companies given the increased focus by regulators, investors, equity holders, boards of directors and consumers. In a 2021 Baker Tilly survey, 60% of dealmakers reported walking away from an investment due to a negative ESG assessment. Companies are very much aware that an appropriate focus on ESG (rather than a check-the-box posture) may correlate to value creation and an advantage over competitors that have not emphasized ESG policies and practices. Corporate dealmakers are quite aware that M&A is a rapid way to meet ESG goals and address salient ESG concerns raised by stakeholders. Another trend that will continue in the second half of 2022 are private equity firms seeking companies that can be easily and quickly transformed into ESG superstars, thereby facilitating the exit strategy for such investments.

Heightened enforcement by the U.S. Securities and Exchange Commission (SEC), as well as an increased layer of due diligence and disclosures required for an ESG deal, places additional burdens on corporate dealmakers and attorneys. Businesses who want to maintain high ESG ratings often turn to in-house counsel or legal advisors for insights into how to handle complex situations. A good example of this is the swift departure of businesses from Russia at the outset of the Ukrainian invasion. It's safe to say that any business looking to be acquired in 2022 and thereafter will want to pay keen attention to a target company's ESG rating.

It is clear that M&A in 2022 has been impacted by numerous economic and regulatory variables, which has created a significant amount of volatility and uncertainty. The volatility and uncertainty have made it more difficult to value and price target businesses. Not surprisingly, sellers have not brought down their pricing expectations so there is currently a valuation mismatch between buyers (who have money to spend but not at the current valuations) and sellers who missed last year's sell window. These factors have created a significant headwind for M&A dealmaking. If conditions persist (and it may take a few quarters to sort itself out), it may place pressure on certain companies and create opportunities for restructuring specialists and distressed investors.

That said, while some may be concerned about inflation and rising interest rates, historically these have not been halting factors for M&A. Although the cost of capital has increased and there is an overhang on the syndicated bank market, many companies are sitting on record numbers of cash reserves, and private equity and family office investors still have significant amounts of cash ready for deployment. In addition, there is a great deal of wealth migration coming from Latin America and Europe, all of which is waiting to be utilized. Dealmakers willing to assume more risk in this volatile environment are often rewarded down the road in the form of higher stock prices and exit valuations. While we may not see the dollars or volume of 2021, it's safe to say savvy businesses will continue to make deals in the remainder of 2022 and attorneys will need to be prepared to weather the changing market conditions.

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