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The Litera Annual M&A Report 2021

Insights & Trends

The global M&A market faced unprecedented levels of uncertainty in 2020, only to recover at record-breaking heights this year. Below the surface, however, the due-diligence process has changed substantially.

Data provided by PitchBook.

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Contents

3 Executive Summary

4-8 Dealmaking Trends

9-10 Cross-border Spotlight

11-12 Meeting the Demands of Today's M&A

13-14 Q&A

15 Methodology

Source: PitchBook | Geography: Global | As of September 14, 2021

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Executive Summary

The global mergers & acquisitions (M&A) market faced more uncertainty in 2020 than it has in many years. A worldwide pandemic combined with major political and financial headwinds to create the most disruptive environment since the 2008 financial crisis.

While dealmaking paused in the middle of the year, it came roaring back in the last months of 2020. This momentum continued into 2021, and global dealmaking is set for a comeback year. While pent-up demand is a large part of the story, that trend may not hold true for much longer.

The more important story over the near term is COVID-19's impact on society. Health precautions, government regulations, and travel restrictions have changed the way people behave, and many of those changes will likely prove permanent. Fortunately, many of those behavioral changes benefited from pre-existing technology. E-commerce, for instance, was already well under way before the pandemic, but it became a necessity under lockdown. Consumer adoption skyrocketed and new habits were formed. The same happened with telemedicine, a niche category in the healthcare sector before COVID-19 struck. Health precautions led to a massive surge in digital health appointments. Today's healthcare providers now need to meet high expectations from their patients, who will increasingly demand digital options from their doctors going forward. Similar stories can be told in remote learning, remote working, payment processing, and digital entertainment.

Entire industries were caught unprepared for the pandemic, but the responsibilities fell on individual companies. Some had strong balance sheets in early 2020, while others had less wiggle room for unexpected disruption. Some became buyers of assets while others became sellers. Divestments of non-core assets became a common solution for cash-strapped companies. Stronger businesses were able to take advantage, buying assets at significant discounts and gaining market share at the expense of competitors. A commonality developed between buyers and sellers—going forward, they needed to be conscientious of their priorities and act accordingly.

Using M&A figures from PitchBook, this report sheds light on those priorities and motivations. Deals struck today will have profound implications in the coming years, and corporations around the globe are racing to get ahead of the curve, or at least before their competitors do.

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Dealmaking Trends

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All things considered—a once-in-a-century health crisis, economic fallout, an unpredictable political environment, and burdensome regulatory changes—M&A was surprisingly resilient in 2020. Deal volume dropped by just 6.6% compared to 2019, while aggregated deal value declined a steeper 13.7%. A record Q4 2020 helped resuscitate year-end numbers, with more than 3,000 deals closing globally that quarter. That strong momentum continued into 2021, with a combined 8,561 transactions closed between Q4 2020 and Q2 2021. By itself, that three-quarter recovery saw more deal volume than all of 2017.

The recovery featured a mix of pent-up buy-side demand and new opportunistic deals, making it difficult to characterize the recovery with a singular explanation. While travel restrictions and safety measures made due diligence more difficult, some deals had already gone through the process in earlier quarters. There were several acquisitions where the buyer had passed on a deal pre-pandemic, but due-diligence records could be dusted off when valuations dropped. In other instances, buyers reacted to their new circumstances, using M&A channels to bolster market share, expand geographically, or acquire new capabilities.

The same dynamic was evident in private equity (PE). While platform acquisitions were stalled, add-on acquisitions flourished in 2020. Both volume and value levels were almost unchanged YoY. PE sponsors used the downturn to acquire smaller competitors for their portfolio companies. Add-on sentiment was positive most of the year, while questions surrounded potential platform acquisitions. Through mid-September 2021, that trend has only strengthened. $471.2 billion worth of add-ons have already been made this year, close to record levels. Add-on volume, currently at just under 5,000 globally, will be in record territory before the year is done.

Global M&A activity by quarter
Q2-Q4 rebound

MEDIAN
+126%

DEAL VALUE
+95%

Source: PitchBook

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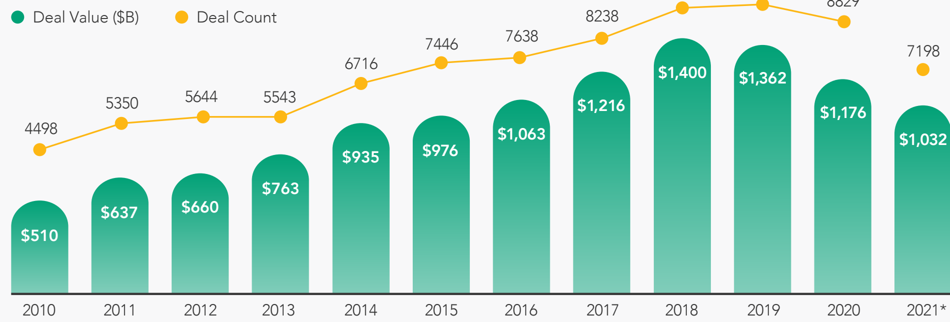
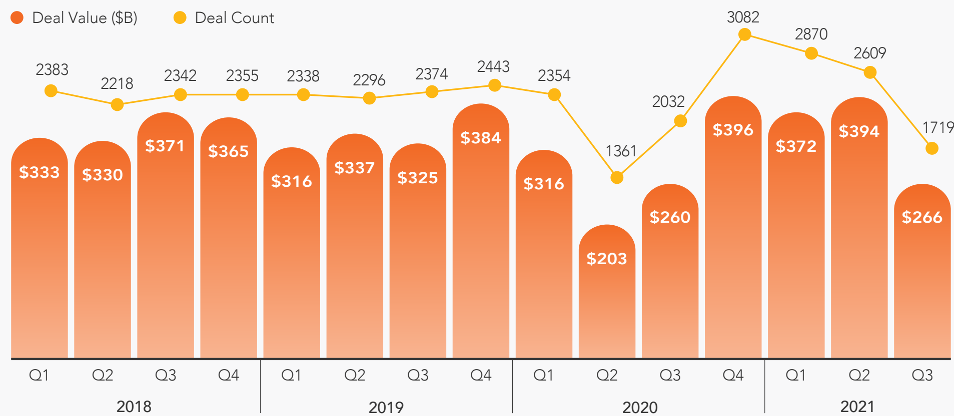
Global M&A Activity by Year



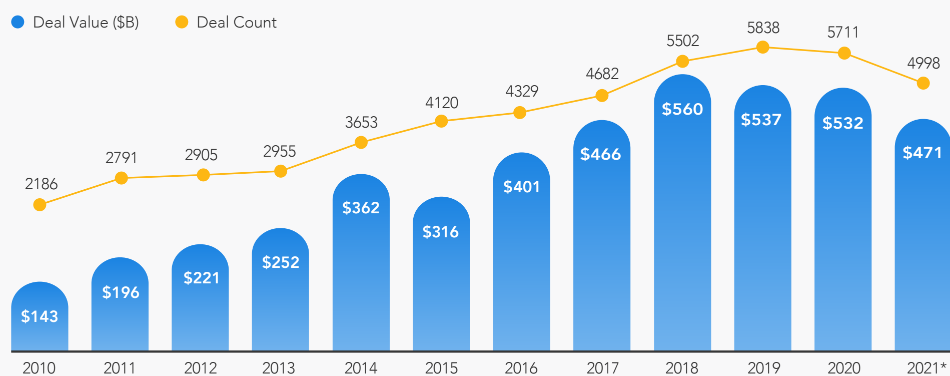
Source: PitchBook
*As of September 30, 2021

Global M&A Activity by Quarter



Source: PitchBook

Global PE Add-on Activity



Source: PitchBook
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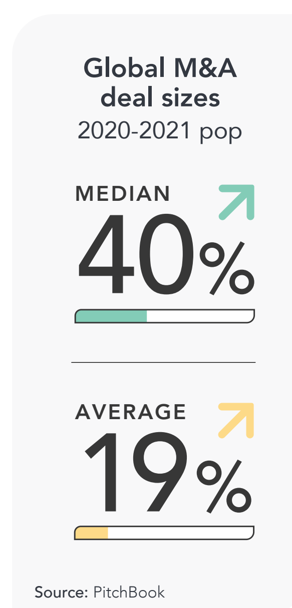
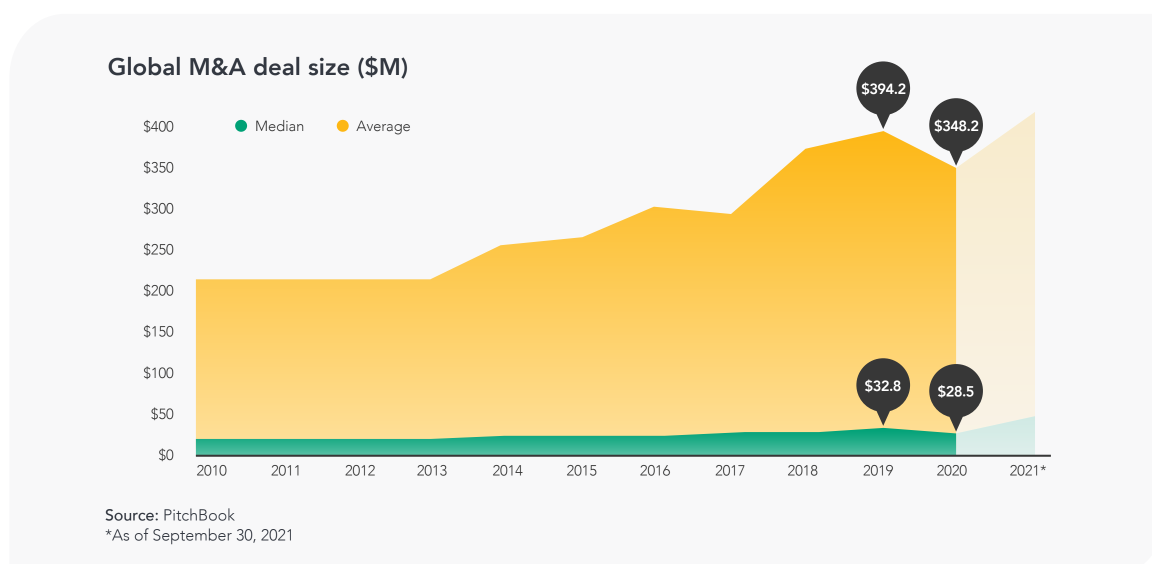
Unsurprisingly, M&A deal sizes dropped in 2020. Across the world, the average deal size had incrementally increased every year since 2013. The average peaked at $394.2 million in 2019, close to double the average from a decade ago. 2020 felt the impact of COVID-19, with the average dropping 11.6% in one fell swoop. The median deal size also fell by 13.1%. Splashy deals were not entertained for a large portion of the year, especially if would-be buyers had more pressing issues to solve internally.



2021 is a different story. Through mid-September, the average 2021 deal size is north of $400 million and 19.0% above 2020's average. The median ($40.0 million) is also higher, 40.4% above 2020's $28.5 million median. There are several explanations for the change. In 2020, many companies took themselves off the market, especially if they were directly impacted by COVID-19 restrictions. An untold number of deals were scuttled by buyer and seller disagreements. Sellers became unwilling to sell at high discounts, particularly ones that had performed well before the pandemic struck. Buyers had their own hesitations around optimistic revenue projections. Those dynamics became even more important at the upper end of the market, where errant assumptions are magnified.

Valuation figures, on the other hand, were a surprise to many. At the outset of the pandemic, there was some consensus that transaction multiples would have to decline. Instead, they stayed roughly the same, varying only by industry. The global median EV/EBITDA multiple in 2020 hit 10.5x, the same multiple as 2019. The 2021 median has increased to 11.4x YTD, on pace for the highest EV/EBITDA multiple ever recorded. The same buyer/seller disagreement kept many struggling companies off the market last year, increasing the ratio of healthy companies available to buy. Many companies actually benefited from the environment and enjoyed a "COVID premium," a trend that continues for segments such as software and tech-enabled consumer.



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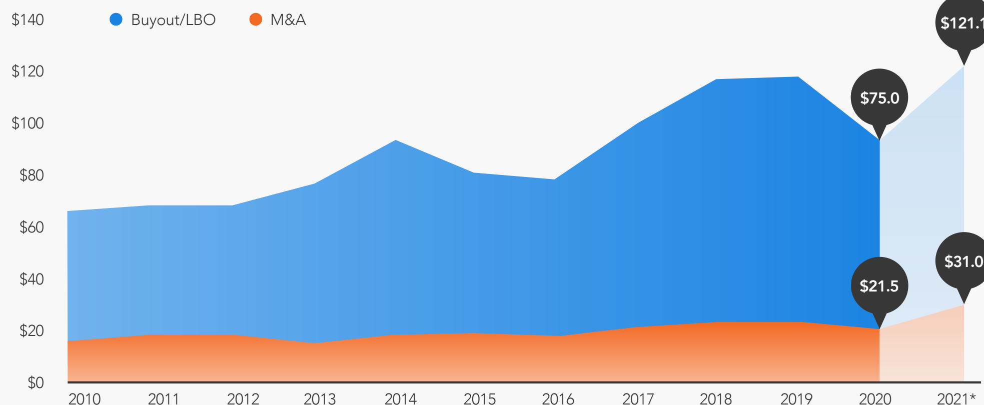
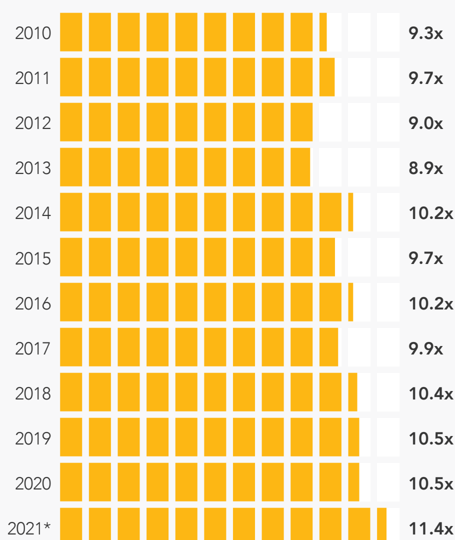
Global M&A deal size by type ($M)



Source: PitchBook
*As of September 30, 2021

M&A EV/EBITDA multiples



2020-2021 **UPTICK** 9%

Source: PitchBook

COVID-19 had disparate impacts on the global M&A market. From a sector level, segments such as travel, restaurants, hotels, and entertainment all suffered. Others—such as software, fintech, and telemedicine— surged in usage out of necessity. Dealmaking figures reflect those impacts. Deal volumes decreased in 2020 in B2B and consumer but increased in healthcare, financial services, and information technology. The immediate impact on those sectors was also revealing—between Q1 and Q2 2020, deal value dropped by 56.5% in business products & services and 48.8% in consumer products & services, while both IT (-22.5%) and healthcare (-23.1%) decreased at relatively modest rates.

COVID-19's impact went well beyond macro considerations; as companies assessed their revenue projections, management teams began reassessing their broader, long-term business strategies. Tectonic shifts across several markets have spurred a wave of deals sized $1.0 billion or larger.

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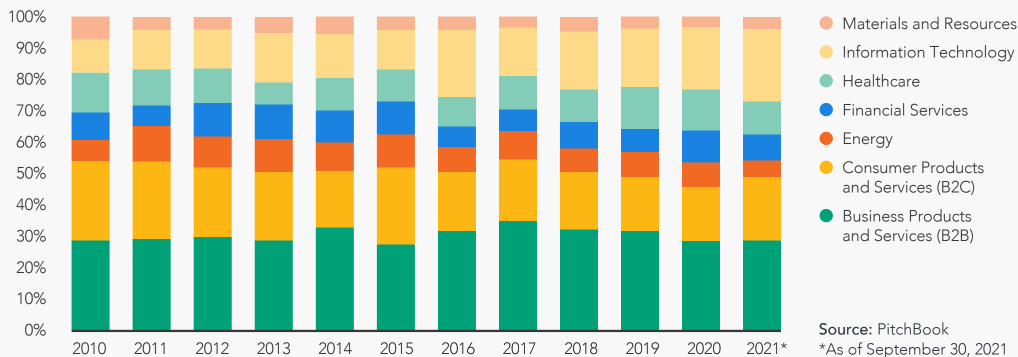
In July, for example, Salesforce (NYSE: CRM) paid $27.7 billion to acquire Slack, the work collaboration and messaging platform. Commenting on the deal, Slack CEO Stewart Butterfield saw a "once-in-a-generation opportunity to rethink and reshape how and where we work." In addition, Just Eat Takeaway (NASDAQ: GRUB) acquired Grubhub, the US-based food delivery service, for $7.3 billion in June 2021. Grubhub represents one of the many food delivery brands that benefited from consumers staying home during the pandemic. Finally, Tyson Foods (NYSE: TSN) sold off its pet treat business to General Mills (NYSE: GIS) for $1.2 billion. Pet adoption rates increased substantially during the pandemic, expanding the overall market for consumer foods heavyweights like General Mills.

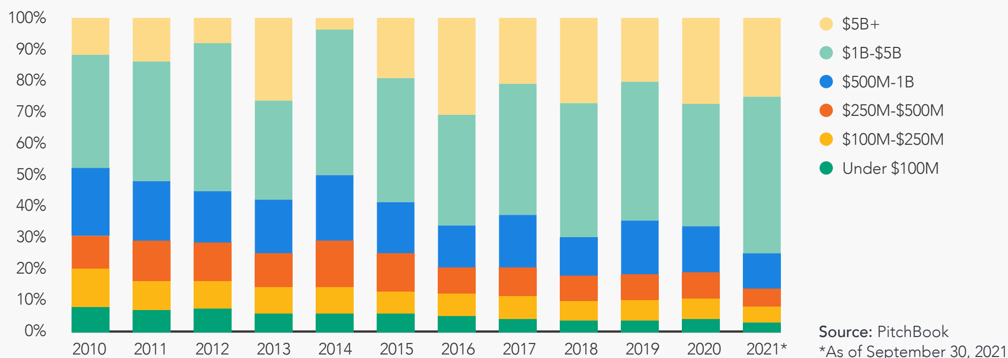
There are dozens of other examples, with major strategic moves in semiconductors, software, energy, digital payments, and telecom, among other sectors. So far, the most noteworthy deals have happened at the upper end of the market, which usually sets the tone for smaller players in the middle and lower middle markets. Over time, similar deal trends will play out at the lower rungs.

Global M&A deals ($) by sector



Source: PitchBook
*As of September 30, 2021

Global M&A deals ($) by size bucket



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Cross-border Spotlight

Cross-border M&A slowed considerably in 2020. Deal volume fell 9.6% while combined transaction value fell by 22.0%. The decline was most felt at the outset of the pandemic. In Q1 2020, cross-border deal volume hit 601 transactions before dropping to only 383 transactions in Q2. Travel restrictions, revenue uncertainty, and due-diligence concerns were all top-of-mind for several months. The recovery was quick, however, with quarterly volume more the doubling by Q1 2021.

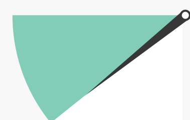
Of course, 2020 was defined by more than COVID-19, including major political events that impacted foreign deal sentiment. The pandemic fostered other questions around governance, including stimulus measures, governmental policies and regulations, and the strength of local economies. A slew of factors combined for a historic level of uncertainty in international expansion—not the least of which involved security concerns, with many significant deals nixed by local regulators in the US, Europe, and elsewhere.

The cross-border transactions that did happen were fueled by ambition and optimism. Buy-side strategics saw the downturn as an opportunity to expand at relative discounts, as long as their own balance sheets allowed for it. Major deals were recorded in luxury apparel, with LVMH (Paris) acquiring New York-based Tiffany for $15.8 billion in January 2021. In Europe, a tie-up in the digital payments space between Nets (Denmark) and Nexi (Italy) laid the groundwork for an industry juggernaut across the continent. Just Eat Takeaway's previously mentioned acquisition of Grubhub highlights the Amsterdam-based food delivery company's ability to grab significant market share in the US.

Global cross-border M&A deal activity
COVID-19 slowdown (2019-2020)

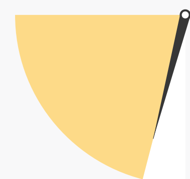
DEAL VOLUME

-10%



DEAL VALUE

-22%



Source: PitchBook

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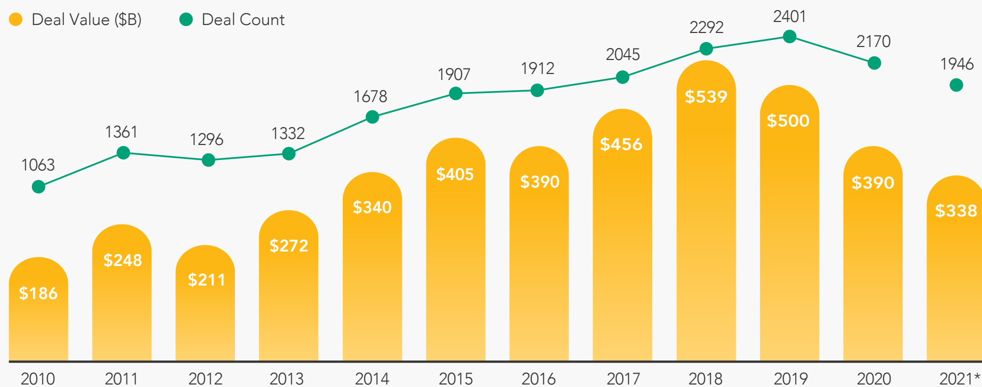
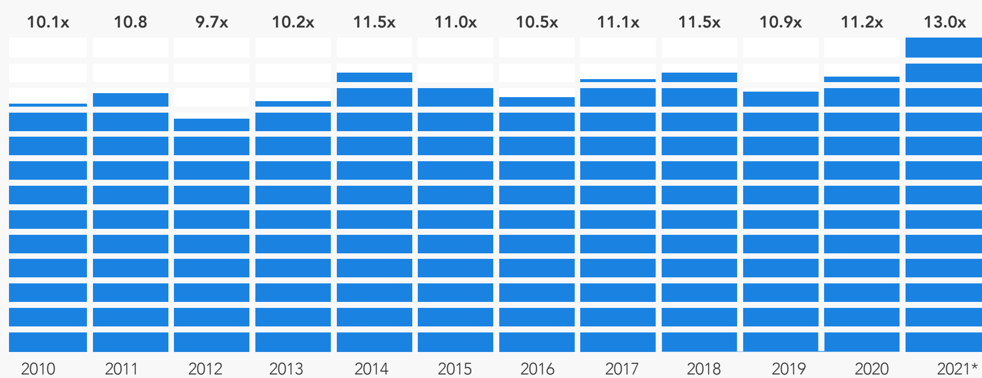
On the other hand, many would-be buyers simply sidelined themselves during the pandemic. That was especially true for hard-hit sectors that were directly impacted by the virus—too many internal problems needed to be solved, leaving no appetite for buying other companies. As a result, the 2020 market was less crowded, leading to inevitable declines. However, as a future in a post-pandemic world begins to clarify, cross-border transaction levels will catch up to historic norms.

Global cross-border M&A deal activity



Source: PitchBook
*As of September 30, 2021

Global cross-border M&A EV/EBITDA multiples



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Meeting the Demands of Today's M&A

Recent discussions with M&A partners from leading law firms have addressed new approaches to risk, implications for the future of due diligence, and the increasing role of technology in this new era. Two important trends focused on were overall speed and novel uncertainties in today's dealmaking.

DEAL TIMELINES ARE GETTING EVEN SHORTER

Deals are being executed faster because of an increasing urgency to move during windows of opportunity. Some lawyers are observing cases where deals are rushed and mismatches in understanding between the parties—such as earn-out provisions—can arise. That press for speed is adding to transaction risks and can sometimes lead to buyer's remorse.

Shorter timeframes might be pushing people to take bigger diligence risks and cut corners.

With shorter timelines, populating the data room in an organized manner has become more difficult, and the quality of the data room's content is therefore poorer.

Another concern is the quality of vendor due-diligence reports—increasing the risk of missing key information due to the speed at which they are being put together by vendors. Additionally, emerging areas of risk analysis, such as environmental, social, and governance (ESG) diligence, are suffering because the urgency of getting deals done has limited the development of standards for addressing these factors.

Where speed is key, accuracy and comprehensiveness are at risk. Firms have a responsibility to help their clients avoid buyer's remorse down the line. Hence, there has been significant investment in advanced technology such as AI-powered document review systems. Although they often require specific training on relevant datasets (for example, similarly structured deal documentation), these systems can help surface key provisions faster. Deal teams often still require subject matter expertise and experience to identify which terms usually translate to the most risk, but these tools can still help expedite due diligence. However, at a certain point, reductions in the time taken to close a deal sacrifice too many aspects of traditional diligence. Fund managers and service providers, such as law firms, are exploring this fine line. For now, investment in any type of tech tool will likely rise as companies prefer to invest in such resources rather than raise the risk of a given transaction.

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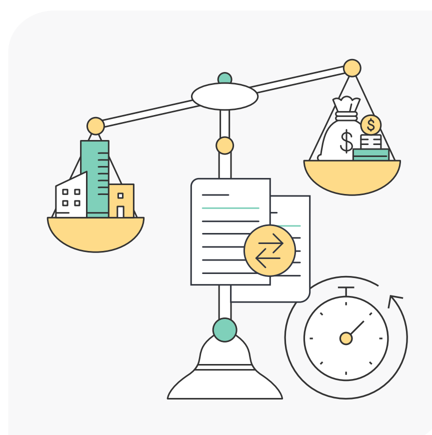
VALUATIONS ARE MORE COMPLEX AND UNCERTAIN

Valuation uncertainty has also been exacerbated by the COVID-19 pandemic. By now, COVID-19 has been baked into many valuations, but even if there is a general rebound in fighting the pandemic, COVID-19 considerations and risks will likely remain as a factor reflected in the price of an asset.

These effects are still uneven by industry, putting traditional valuation techniques to the test. For example, EBITDA has become less relevant as a valuation standard in new industries such as clean tech. Valuations can also be affected by a mismatch between the parties where there is a big buyer and a smaller, less sophisticated target. As some industry participants throw traditional rule books out the window, as the relevance of traditional valuation metric declines, fund managers are turning to alternative datasets or taking relatively rosy outlooks.

The most notorious example is the proliferation of treatments of EBITDA—that is, the varieties of "adjusted" EBITDA that have occurred. However, rather than modifying accounting practices, there are often additional resources that can be utilized. For example, advanced models that forecast more scenarios with probabilities can be developed using bespoke software packages to complement traditional Excel models. Granted, such tools usually have to be contracted or purchased outright, but these can expedite deals or improve confidence in future projections of synergies or savings resulting from a merger. Ultimately, PE fund managers and accounting teams may develop new types of metrics that can augment customary measures, such as EBITDA multiples, but they will not become mainstream until sufficiently proven out.



The dynamic nature of COVID-19 has injected other uncertainties as well. In many deals, valuations are not fixed, and instead multiple ranges are discussed, which might be revisited and revised many times during a transaction. In scenarios such as these, additional user-friendly forecasting can prevent manual reworking by associates in Excel models.

M&A teams can't control many of the intangibles and unexpected events during a transaction, but they can use technology to ensure that decisions are made based on the most complete set of available data. This is where a total diligence approach that uses the right variety of digital tools can create value. By leveraging AI-based document review on the maximum number of documents, the risks can be balanced by a greater confidence that the available documents have been fully explored. The more data that can be included in the analysis, the more confidence the players can have in valuations, despite uncertainty. After due-diligence review has been completed, transaction management technologies can help the rest of the transaction run smoothly so lawyers can focus on the deal, not on how they're managing it.

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Q&A

From a volume perspective, please share your thoughts on the current M&A market and what's driving today's sentiment.

There's little doubt among those watching the current M&A market that low interest rates, a resilient stock market, and record amounts of private capital have created and sustained an environment ripe for dealmaking. And, notwithstanding the persistence of the COVID-19 pandemic, I sense a growing optimism that some level of normalcy is returning, and that an end may even be in sight. Regardless of whether that optimism is grounded in higher vaccination rates, or just wishful thinking, potential dealmakers are increasingly looking ahead for what's next rather than ruminating over the effects of the past 20 months. Lastly, I also believe FOMO—fear of missing out—is a factor in today's M&A market, particularly on the sell-side for privately owned and family owned businesses.

Paul Jaskot, Partner, Holland & Knight

Overall, we have seen robust M&A activity in the first three fiscal quarters and expect that to continue and even accelerate into the fourth quarter this year. Our transactional practices across the board (PE, M&A, VC, and so on) are seeing increased activity, and every deal lawyer I talk to, both at our firm and other firms, seems to be at about maximum capacity. In my view, the market is being driven by a number of factors on both the buy-side and sell-side. On the sell-side, prominent factors include increased volatility in the business due to the pandemic (or fundamental business changes resulting from the pandemic), perceptions regarding likely changes on the capital gains rates, and overall population demographics as Baby Boomers continue to look to exit businesses. On the buy-side, the historic levels of dry powder, the frothy equity markets, and the continued availability of relatively cheap credit continue to drive activity.

Eric Goodman, Partner, Ice Miller LLP

In your view, what are the key differences between today's M&A market and the pre-pandemic market?

If I were to point to one word to sum up the difference between today's M&A market and the pre-pandemic market, it would be "urgency." Certainly, some of this urgency has been fueled by anticipated changes in capital gains rates and other tax laws. However, in a highly competitive M&A market, speed to execution is being demanded and is absolutely essential for sellers, buyers, and their respective advisors and service providers to demonstrate.

Paul Jaskot, Partner, Holland & Knight

Speed and certainty to close have become key differentiators, even more so than in the past. The timeline to close deals continues to accelerate as increased uncertainty from the pandemic drives buyers and sellers to want to close before the next bad news comes out. During the peak of the pandemic, the fear of what could happen tomorrow was palpable and understandable. But even as we have slowly returned to normal (or partly normal), we have seen that the hurry up and get it down mindset has persisted; it can be hard to recalibrate expectations and go back to "how things used to be."

Eric Goodman, Partner, Ice Miller LLP

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With so much uncertainty across several sectors of the economy, please share your thoughts on due diligence in the current market.

Similar to the downturn post-2008, we are seeing financial due diligence become even more important and often act as the gating item before legal work begins. In addition, there are a number of new items that are being added to checklists around pandemic-related items like PPP and EIDL loans and compliance with COVID-19 mandates and protocols.

Eric Goodman, Partner, Ice Miller LLP

At the height of the pandemic, there were substantial questions around revenue projections and their impact on valuations, with buyers and sellers often not seeing eye to eye. To what extent has that remained an issue under the Delta variant, especially for hard-hit industries?

We have seen a number of deals in 2021 with significant revenue misses and purchase price adjustments. We are also seeing a significant number of deals with earnout structures, which are often used to bridge gaps on valuations. I am not seeing as many deals with equity consideration as I expected, which is likely tied to the state of equity and debt markets. The volatility caused by the pandemic certainly continues to effect decision making on both buy-side and sell-side, and by and large seems to be keeping valuations relatively in check. This does, of course, vary on an industry-by-industry basis.

Eric Goodman, Partner, Ice Miller LLP

What is your near-term outlook for global M&A, heading into 2022 and beyond?

Overall, I expect M&A activity to remain strong for the remainder of 2021 and 2022. Rising interest rates and tax rates may create some headwinds, but I anticipate strong demand from both financial and strategic buyers due to continued fund formation activity and healthy corporate balance sheets.

Eric Goodman, Partner, Ice Miller LLP

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Methodology

M&A is defined as the substantive transfer of control or ownership. We track only completed control transactions. Eligible transaction types include control acquisitions, leveraged buyouts (including asset acquisitions), corporate divestitures, corporate asset purchases, reverse mergers, spinoffs, and asset divestitures.

- Debt restructuring or any other liquidity, self-tenders (in which a company undertakes an offer for a typically limited number of its own shares to ward off a hostile takeover) or internal reorganizations are not included.
- Announced, rumored or canceled deals are not included.
- Aggregate transaction value is not extrapolated using known deal values, unless otherwise noted as estimated.

Capital invested is defined as the total amount of equity and debt used in the transaction. PitchBook's total capital invested figures include deal amounts that were not collected by PitchBook but have been extrapolated using a multidimensional estimation matrix. Some datasets will include these extrapolated numbers while others will be compiled using only data collected directly by PitchBook; this explains any potential discrepancies.

Due to the nature of private market data, information often does not become available until well after a transaction takes place. To provide the most accurate data possible, we estimate how much of this new information will become available in the next quarter by calculating the average percentage change in deal flow from the first to second reporting cycle over the trailing 24 months. We then add this estimate to the reported figure for the most recent quarter. Both the original reported figure and the estimated figure are provided for your reference.

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