Katten

CORPORATE ADVISORY

UK and European M&A: Predictions for 2024

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2023 was a challenging year for mergers and acquisitions (M&A). Volumes of deals and deal sizes were both down due to, amongst other factors, historic levels of inflation, rising interest rates, heightened regulatory scrutiny in many jurisdictions and geopolitical instability. Whilst M&A in the Europe, Middle East and Africa region (EMEA) remained resilient in the first half of 2023, deal activity fell in the second half of the year. Overall, in 2023, initial public offering (IPO) activity and private investment weakened, and global deal M&A value and volume declined, compared with 2022.[1] The $1.95 trillion of global M&A volume through the third quarter of 2023 represented a 33 percent year-over-year dollar volume decline and the lowest three-quarter total since 2013.[2]

That said, despite the continued volatility in the debt markets, M&A remained an important part of companies' growth strategies in 2023, which should continue into 2024. With inflation having eased across the United States, the UK and EU, interest rates are likely to decrease this year and commentators across the board are predicting an improved deal environment for 2024.

Below are our top five M&A predictions for 2024.

1. Heightened regulatory scrutiny

Heightened global regulatory and merger scrutiny from authorities across continental Europe and the UK, is expected to continue into 2024, becoming an increasing priority in the due diligence phase of an M&A transaction. In particular, competition and anti-trust-related concerns have led to the abandonment, delay and restructuring of several notable of deals in the technology space recently. National security concerns also have given rise to increasing scrutiny of deals across all sectors, emphasizing the transactions in the technology sector. This has already led to an increased focus on regulatory risk-sharing and related contractual provisions such as "drop-dead" dates, reverse termination fees and efforts covenants. These provisions are typically negotiated heavily and, in some cases, can lead to the deal failing to close, especially for large companies with a significant market share and cross-border deals involving industries such as pharmaceuticals, where competition issues are more common and regulators are more focused.

Considering the increased regulatory environment and the high-interest rate environment, dealmakers have been increasingly targeting, and will continue to target, smaller mid-market transactions that are easier to execute and less risky to finance.

2. Environmental, Social and Governance (ESG) factors

A notable area of increased and increasing regulation is ESG. In 2023, the desire to have investment managers focused on sustainability, ESG and management of carbon emissions accelerated significantly, partly due to the introduction of various ESG-related regulations.

In the European Union, the Corporate Sustainability Reporting Directive (CSRD) and the Carbon Border Adjustment Mechanism (CBAM) were introduced, influencing investment decisions and capital allocation. In addition to these

[1] See "Dealmakers see rebound after global M&A volumes hit decade-low," 21 December 2023.

[2] See "ANALYSIS: Dismal Q3 M&A Deal Volumes Dampen End-of-Year Outlook," 10 October 2023.

two regulatory regimes, there are many more pending in the EU set to tackle subjects like banning imports into the EU produced with forced labour, new deforestation due diligence requirements and new enhanced human rights due diligence requirements (the latter of which may come into force as early as H1 2024 in the form of the Corporate Sustainability Due Diligence Directive (CSDDD)). Meanwhile, the UK has adopted various ESG-related operating and disclosure requirements over the last few years, all of which have contributed to a heightened focus on ESG in the M&A due diligence process.

On the other hand, it is worth noting that the story around ESG in the United States is more complex. While ESG continues to be the subject of political debate, regulations are being introduced in certain US states, with California having introduced three pieces of climate disclosure legislation, as well as at the federal level, with the Securities and Exchange Commission (SEC) introducing climate risk disclosure rules in early 2024. The impact of the presidential election in November 2024 may affect the expansion of ESG regulations across the United States, as certain groups have been highly critical of the wider ESG movement.

The growing importance placed on ESG by both buyers and sellers has become widespread in the large and middle-market M&A transactions, with it being fairly common to include ESG-specific warranties from sellers. This will remain important for M&A diligence and risk and opportunity assessments in 2024.

3. Increasing shareholder activism

Shareholder activism continues to be a major factor in M&A deals and will continue to have a meaningful impact on the M&A market in 2024. Notably, 252 new campaigns were initiated globally in 2023,[3] many of which focused on breakup transactions or divestitures of specific lines of businesses seeking to stifle or promote previously announced transactions.

Shareholder activists will be increasingly vocal about companies "tightening their belts," placing a greater emphasis on optimising efficiency from within by making cost-cutting measures and balancing out their balance sheets.

4. High-growth sectors

M&A deals involving assets in high-growth sectors such as artificial intelligence, technology, life sciences and health care are expected to increase in 2024. In these sectors, dealmakers have been able to bridge the valuation gap more easily.

For example, in the health care sector globally, macro trends such as aging populations and evolving health care needs in a post-pandemic world are driving investment. This has been especially prevalent in China where government policies have focused on upgrading health care services. Additionally, Australia's rapid population growth also is placing demand on the health care sector, resulting in an increase in day hospitals, home health care (e.g., AI-enabled health care) and investment into mental health services.

5. Private Equity (PE) activity

PE activity is expected to increase in 2024, even though valuations are lower than in 2020, 2021 and early 2022. This is largely due to the pent-up demand among PE funds and strategic buyers as well as the gradual pick-up in activity towards the end of 2023[4] indicating that whilst the overall deal values and volume declined, PE firms have worked out how to proceed with transactions despite ongoing geopolitical uncertainties and economic challenges.

Some notable strategies adopted by PE funds in 2023, which are expected to continue, have included focusing on specific sectors (using joint ventures with strategic partners as a means of entering a new sector), acquiring minority stakes, buying assets from themselves via continuation funds and making higher cash contributions. The latter will likely continue as the transaction appetite remains irrespective of fluctuating interest rates as private equity funds still have large amounts of dry powder to deploy. According to S&P and Preqin estimates, global private equity dry powder reached $2.59 trillion in 2023.[5]

3 See "Annual Review of Shareholder Activism 2023," 8 January 2024.

4 See "Dealmakers see rebound after global M&A volumes hit decade-low," 21 December 2023; "Deal Drivers: EMEA Q3 2023," 7 November, 2023; and "Deal Drivers: Americas Q3 2023," 7 November 2023.

5 See "Private equity firms face pressure as dry powder hits record $2.59 trillion," 13 December 2023.

Strategic partnerships and joint ventures, distressed acquisitions, bolt-on acquisitions, divestitures, and carve-out transactions are all likely to increase in 2024.

Conclusion

Heading into 2024, potential for disruption to the M&A market remains high making it hard to predict what is to come with certainty. Global macro factors such as high borrowing costs, geopolitical conflict, interest rate cuts and the unprecedent number of elections taking place across the world (including in the United States, UK and India) may affect an M&A rebound across Europe and the UK, and perhaps in other regions. Even so, improving visibility about market conditions in 2024 (notably greater clarity of the trajectory of interest rates) brings increased confidence to the M&A market as a whole and the general consensus and predictions for M&A activity in 2024 are promising.

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