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## DR. T ON SECURITIES

## M&A dry powder will drive spending spree

By Sara L. Terheggen

It is widely publicized that 2021 was a record-breaking year for M&A, with deal activity exceeding \$5 trillion globally. As we glide closer to the second half of 2022, it is clear that deal activity is increasing and expected to remain strong through the end of the year, predominantly because the foundational aspects in place in 2021 that drove deal activity are largely still in place in 2022. While deal activity may be subdued purely because of downward pressure on stocks, general inflation and global concerns, as well as internal challenges of supply chain and labor, it is still anticipated that M&A activity will be positive. Limited or depressed access to public markets by public companies is likely to fuel this growth by expanding possible targets at depressed valuations.

### Dry powder to drive M&A activity

The fundamental headwinds that were seen in 2021 that drove deal activity still exist in 2022 despite the various dampening forces. These include available capital from private equity funds and the vast number of available SPACs seeking solid transactions, both of which fueled 2021 activity. Private equity sponsors were sitting on a heap of available capital in 2020 that was deployed in 2021, but private equity sponsors also raised another record \$733 billion in 2021 and reportedly are sitting on \$1.3 trillion of dry powder even as 2021 came to a close.

Despite increasing scrutiny from the SEC and despite a slowdown in the third and fourth quarters of 2021, SPACs still priced over 600 IPOs in 2021. In fact, as of Dec. 31, 2021, over 500 SPACs collectively have over \$138 billion in proceeds seeking viable M&A targets and such dry powder must be deployed either in 2022 or 2023 given the time construct



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implicit in SPACs which only provides a limited window in which to execute a deal before the money would have to be returned to investors.

All this dry powder from private equity and SPACs is bound to generate significant deal volume and deal innovation. In addition, some view the downward pressure on stocks as providing an even more helpful environment for M&A activity by devaluing expensive assets. In addition, the volatile capital markets make M&A a more likely path for companies who are unable to raise capital or execute other types of transactions, such as an IPO or secondary offering for already public companies.

### Considerations for target companies

With all this available dry powder, the competition for attractive acquisition targets is fierce. Targets interested in a possible acquisition should focus on strategic priorities and continue to work on resolving challenges related to supply-chain and labor shortages, immediate and residual impacts from COVID-19, as well as managing through the cost of inflation. Targets should also consider divestitures and spinoffs as a means to strategically re-focus on their core businesses. It is quite possible that roll-up transactions and other

bolt-on acquisition strategies will be popular – especially by private equity sponsors seeking to expand and grow their existing portfolios.

Target companies should recognize that execution of a transaction at a faster pace is likely, especially for public target companies. As such, target companies should get diligence organized and consider legal and financial advisors before they are needed so it will be faster to react to a letter of interest when it comes through the door. This will also help ensure that a target company will be more capable of vetting a potential offer while maintaining a key focus on the business. Boards of target companies should also confirm that appropriate D&O insurance is in place and that all such insurance is up-to-date and that the company has not inadvertently fallen behind on premium payments.

For private companies who may be pursued as possible SPAC targets, such companies need to ensure that all internal financial records are in order, such as quarterly trial balances, historical capitalization tables and executive compensation information.

Finally, targets need to consider and plan for potential litigation in connection with any transaction. M&A litigation has skyrocketed

in recent years, and increasingly, such cases are focused on breach of fiduciary duty. As such, it is important to consider proper corporate governance practices and be ready to implement those in the context of a transaction including, reconciling conflicts; observing proper corporate formalities; devoting time and attention to the various decisions that must be made throughout the process; considering obtaining a fairness opinion; and relying on legal and financial advisors.

### Prepared target companies are prime for dry powder

As private equity sponsors and SPACs look for ways to deploy an immense amount of dry powder raised in 2021, it is likely that M&A activity will remain strong in 2022 despite headwinds of a volatile stock market, inflation pressures and global concerns around war and a never-ending pandemic. To establish themselves as attractive acquisition opportunities, target companies should focus on solidifying business fundamentals, getting organized and establishing a foundation of execution capabilities so they can react quickly to a potential buyer.

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