

Questions That Matter

Corporate M&A | Will Survival Pressure Lead To Consolidation?

We expect to see a spike in M&A activity, not only because of excess liquidity and favorable financing conditions, but as a way for sectors hit hardest by the pandemic to survive.

How this will shape 2021

Preparing for life after COVID-19. The pandemic has created profound disruptions in many industries, threatening carefully calibrated financial structures and strategies. Digital disruption has accelerated further, shifts in working patterns appear likely to persist, and ESG concerns have moved to the fore. M&A is likely to become a critical component of the corporate response to these pressures, either as a means to survival or to take advantage of favorable financial conditions.

Sectors hit hardest by the pandemic and economic slump could be forced into cost-focused rationalization. We expect continued mergers in depressed sectors such as energy, as operators look to gain scale under difficult operating conditions.

Liquidity choices. Record debt issuance this year has poured liquidity onto the balance sheets of companies operating in more resilient sectors. This, combined with historically low interest rates, has the potential to fuel M&A in 2021.

What we think and why

M&A could reach or exceed pre-pandemic levels in 2021. Deal volumes were somewhat subdued for a number of years following the 2007-2008 financial crisis, but we suspect a different pattern is likely during the post-pandemic recovery, with 2021 volumes poised to return to pre-COVID-19 levels, if not surpass them. A surge in M&A deals in third-quarter 2020 indicates this potential trend (see chart).

Growth opportunities are fueling M&A in stable sectors. Much of the recent M&A has occurred in more resilient and stable sectors of technology, telecoms, and health care. While the largest cash deals in 2020 have been led by strategic buyers, we anticipate that the same drivers--excess liquidity and low borrowing costs--will also continue to support acquisitions by financial buyers.

The need to consolidate is emerging in depressed sectors. Not all sectors will enter 2021 on a firm footing, but could still contribute to higher merger volumes. For instance, there have already been a number of large mergers in the energy sector, including the Chevron Corp.-Noble Energy Inc. and ConocoPhillips-Concho Resources deals. We expect further consolidation among oil exploration and production companies.

Small and midsize firms will get in on the action. As many higher-quality names are snapped up, midsize players could merge, or smaller independents will become attractive value targets.

What could go wrong

Stretched valuations. The recent rally in equity markets, particularly in the technology sector, could inflate valuations into territory that could raise concerns about overpaying for assets and unrealistic synergy assumptions.

Credit-quality concerns. The leverage ratios of most firms we rate that have pursued acquisitions of over \$10 billion since 2015 continue to hover well above the levels seen before the deal. Close to 15% of these entities have seen multi-notch downgrades. The credit health of firms that have pursued large deals could quickly deteriorate if growth slows for a prolonged period or access to debt markets becomes constrained.

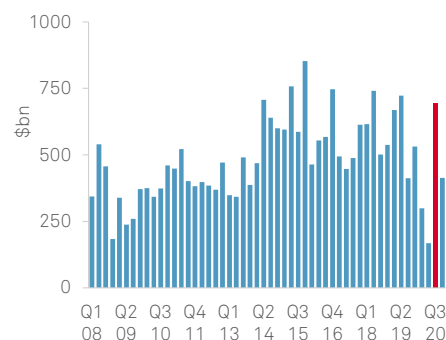
Jeanne Shoesmith, CFA

Chicago
jeanne.shoesmith
@spglobal.com
+1 312 233 7026

David Teshler

New York
david.teshler
@spglobal.com
+1 212 438 2618

Q3 Saw A Resurgence In Deal Activity



Source: S&P Global Market Intelligence; Data as of Nov. 17, 2020.

After a resurgence of deal activity in Q3 2020, M&A volumes look poised to reach or exceed pre-COVID-19 levels in 2021. This brings credit risks and could delay a post-pandemic recovery of credit quality

This report is an extract from the S&P Global Ratings report, "Global Credit Outlook 2021: Back On Track?"

This report does not constitute a rating action

S&P Global Ratings believes there remains a high degree of uncertainty about the evolution of the coronavirus pandemic. Reports that at least one experimental vaccine is highly effective and might gain initial approval by the end of the year are promising, but this is merely the first step toward a return to social and economic normality; equally critical is the widespread availability of effective immunization, which could come by the middle of next year. We use this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of S&P Global Market Intelligence or its affiliates (collectively, S&P Global). The Content shall not be used for any unlawful or unauthorized purposes. S&P Global and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Global Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Global Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P GLOBAL PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Global Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw, or suspend such acknowledgement at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal, or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P Global keeps certain activities of its divisions separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain divisions of S&P Global may have information that is not available to other S&P Global divisions. S&P Global has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P Global may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P Global reserves the right to disseminate its opinions and analyses. S&P Global's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge), and www.capitaliq.com (subscription), and may be distributed through other means, including via S&P Global publications and third-party redistributors. Additional information about our ratings fees is available at www.standardandpoors.com/usratingsfees.

Australia: S&P Global Ratings Australia Pty Ltd holds Australian financial services license number 337565 under the Corporations Act 2001. S&P Global Ratings' credit ratings and related research are not intended for and must not be distributed to any person in Australia other than a wholesale client (as defined in Chapter 7 of the Corporations Act).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.

spglobal.com/ratings