M&A Activity Rebounds Alongside A SPAC-Driven IPO Expansion

MONETARY AND CAPITAL MARKETS DEPARTMENT

April 20, 2021

Merger and acquisition (M&A) activity has experienced a sharp recovery that began in Q3 2020 following an exceptionally weak first half of 2020. Since the beginning of 2021, M&A momentum has accelerated sharply across all regions, with announced global deal volumes reaching $2 trillion in Q1, the highest since Q2 2007 (Figure 1). Record-low funding costs and an improving economic outlook have fueled a rebound in debt funding M&A and LBO activity (Figure 2). The leveraged loan market posted a new quarterly issuance record in Q1 2021 on strong refinancing flows, with more aggressive capital allocation toward M&A and leveraged buyout (LBO) activity (Figure 3), alongside an increase in highly leveraged deals (Figure 4).

Fiscal stimulus and easy monetary policies have also created favorable conditions in public equity markets. Many businesses have focused on listing their stocks on exchanges as quickly as possible to take advantage of elevated market valuations. The volume of initial public offerings (IPOs) has surged, particularly in the US where it hit record levels in Q1 2021. IPO activity has been boosted by the boom in offerings from Special Purpose Acquisition Companies (SPACs), also called blank-check companies. SPACs are publicly-held investment vehicles created specifically to acquire a private company, effectively taking the company public through a reverse merger. Going public through an acquisition with a SPAC is notably faster than traditional IPOs. SPACs raised a record amount of new funds in Q1 2021 and M&A activity involving SPACs has surpassed all of last year's record levels (Figures 5 and 6). SPAC sponsors have targeted purchases in growth industries such as tech, but weaker returns more recently represent a potential headwind to future SPAC issuance (Figures 7 and 8).

The onset of COVID-19 proved to be a significant catalyst in boosting SPAC issuance as companies sought alternative venues to go public following disruptions to their IPO plans. Speed of access, greater control and visibility on pricing, and simpler disclosure requirements are some of the reasons private companies are finding going public via a SPAC as attractive, especially versus a traditional IPO.

The boom in SPAC issuance has displayed some signs of exuberance in investors' behavior amid the low-rate environment. This can be seen in the boom in retail equity trading activity that has increased investor appetite for non-traditional and early-stage businesses and has been one major driver of the SPAC boom. Institutional investors, such as mutual funds and hedge funds, have traditionally been the core investor base for SPAC IPOs. Further, SPACs can also be used to evade disclosures and liabilities inherent upon taking a company public, which may hinder proper risk assessment of these deals, and elevated valuations suggest prices may be misaligned based on fundamentals of the companies targeted for acquisition. SPACs may not pose an immediate threat to financial stability given the lack of significant exposures retained by banks and little known use of financial leverage. But the involvement of retail investors provides an example of the types of financial excess that can emerge in a "search for yield" environment, and as a result it has started to receive more regulatory scrutiny, for example regarding issues related to investor protection and the release of projections and other valuation material that is less common in traditional IPOs. In addition, in the event of significant losses in this sector, a repricing of risk may have an impact on broader risk appetite and financial conditions.

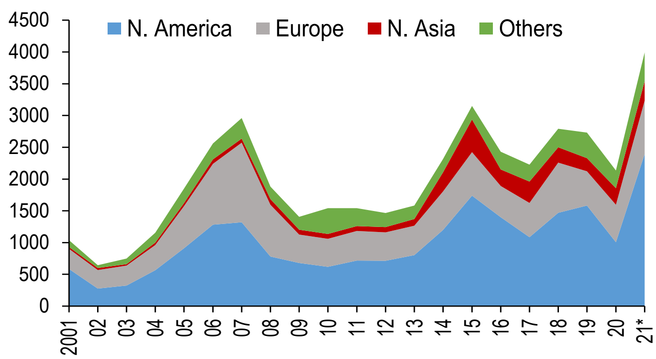
Contributors: Deepali Gautam and Tom Piontek

The ongoing acceleration in M&A activity is expected to continue for three key reasons. First, the strong growth rebound expected in coming quarters should support M&A transactions, given that this type of activity has historically been sensitive to the economic backdrop. Attractive financial conditions should also provide a tailwind for deals that employ debt funding. The second driver is the corporate sector's elevated liquidity buffers (see October 2020 and April 2021 GFSR's) that are expected to be partially spent on diversifying business models post pandemic. M&A transactions offer an alternative to make changes to customer targets, product lines, and geographic coverage. The third driver revolves around the notable amount of dry powder in the private equity space, estimated at a record $1.5 trillion (per Preqin data)—a development that should boost M&A activity backed by financial sponsors. Year-to-date, almost 40 percent of M&A volumes have been related to financial sponsors and are at the highest level post the GFC.

Booming M&A Activity

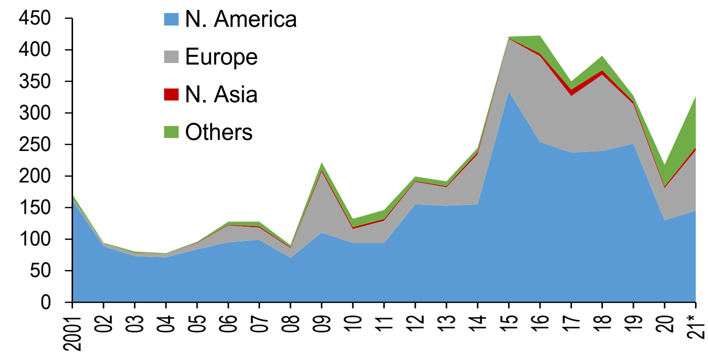
The V-shaped recovery in global M&A volumes has gained momentum...

Figure 1. Global Announced M&A Activity (USD billions; deals greater than $1 billion)



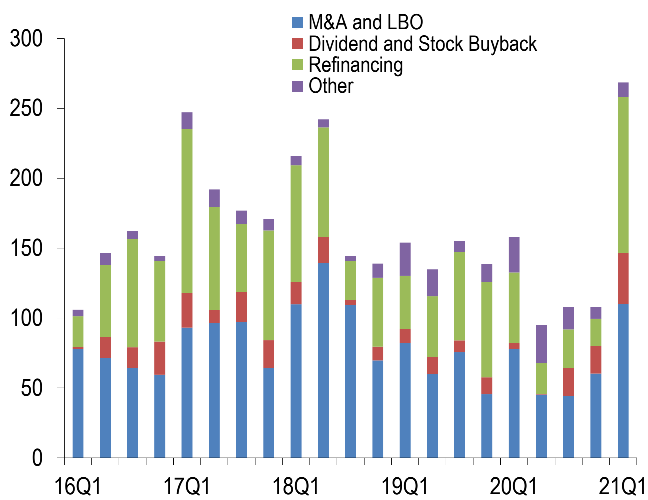
...alongside emerging signs of active re-leveraging through debt funding M&A and LBO activity

Figure 2. Global Corporate Bond Issuance Backing M&A and LBOs (USD billions)



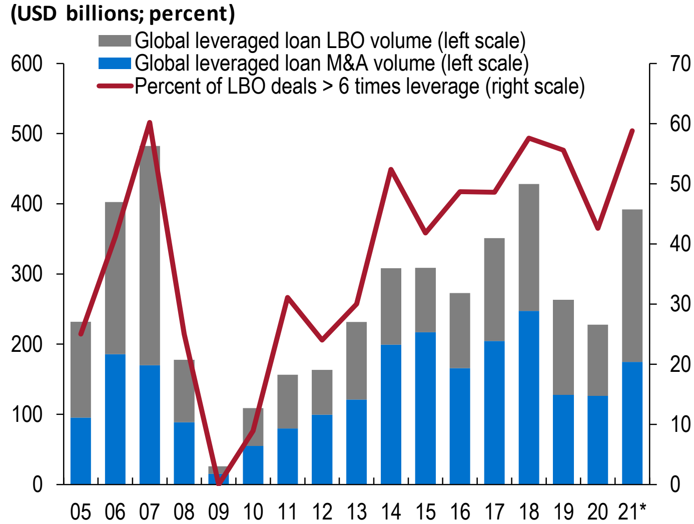
Leveraged loan proceeds used to refinance and fund acquisitions has rebounded...

Figure 3. Global Institutional Leveraged Loan Volume by Use of Proceeds (USD billions)



...and highly leveraged deals have accounted for close to 60 percent of leveraged buyouts

Figure 4. Global Institutional Leveraged Loan M&A and LBO Volume (USD billions; percent)



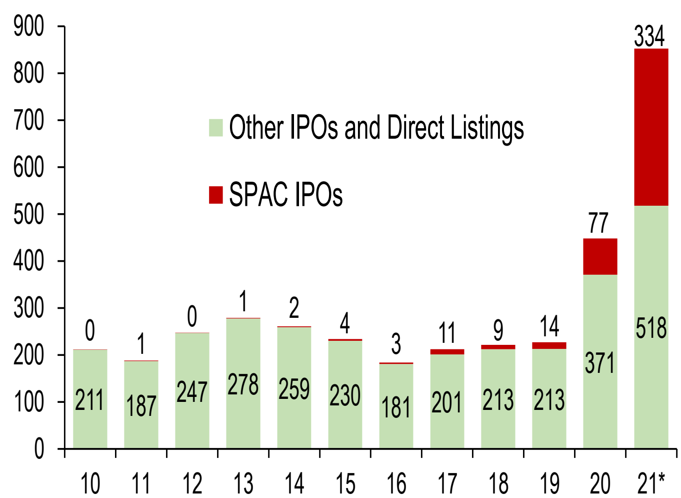
Sources: Dealogic and S&P LCD

*Notes: * For Figures 1, 2, and 4, 2021 data is through Q1 and has been annualized to estimate the full year.*

Special Purpose Acquistion Companies Boosted IPO Volumes

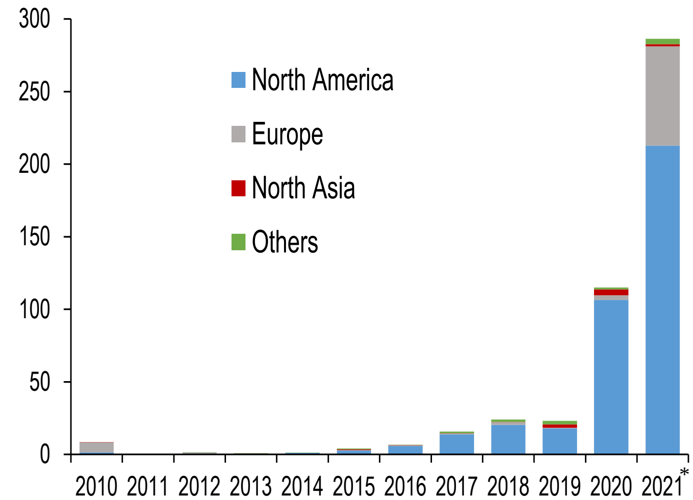
Abundant liquidity has fueled record IPO volumes, with SPACs accounting for close to half of new equity…

Figure 5. North America IPO Capital Raised By Type (USD billions)



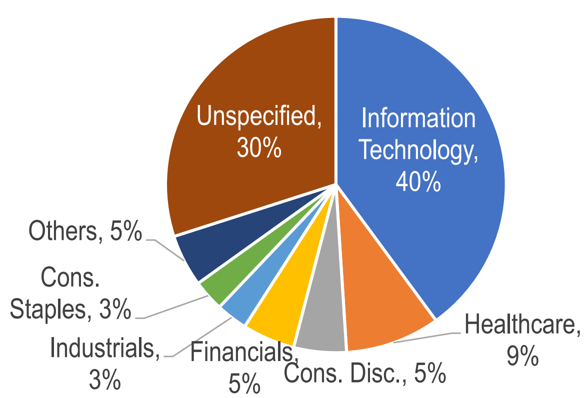
…and leading to a record amount of M&A involving SPAC sponsors taking a private company public

Figure 6. Global M&A Deals Involving SPACs (USD billions)



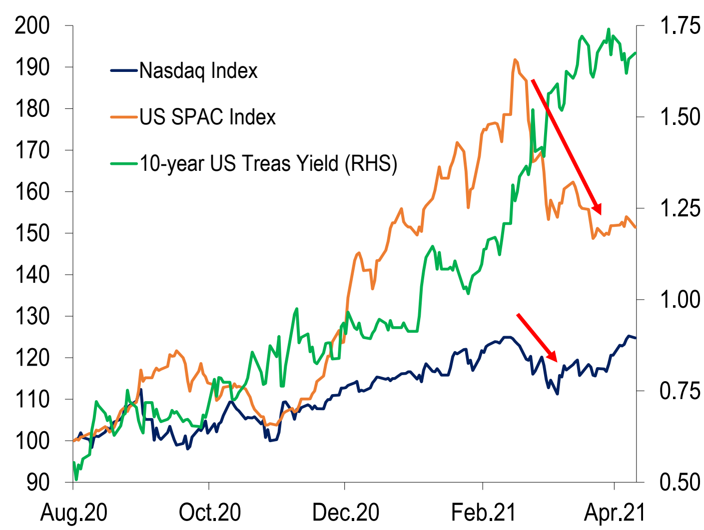
SPAC targets have been concentrated in the tech sector…

Figure 7. 2020 North America SPAC IPO Targets by Industry (Percent of total funds raised)



…while SPAC equity gains have stalled with the recent rise in rates and Q1 tech underperformance

Figure 8. US 10-year Treasury Yield and US SPAC and Tech Sector Performance (Index 100 = August 3, 2020, Percent)



Sources: Dealogic and Bloomberg L.P.

*Note: * For Figures 5 and 6, 2021 data is through Q1 and has been annualized to estimate the full year. For Figure 8, the US SPAC index tracks the aftermarket performance of SPACs which pursue IPOs in the US. The index is market-cap weighted measuring the performance of the 30 largest and most traded public SPACs. The index is intended to capture performance from SPAC IPO to deal consummation and is rebalanced monthly with active assessment in consideration of completed acquisitions, dissolution, or liquidation.*