

# State of the M&A Market

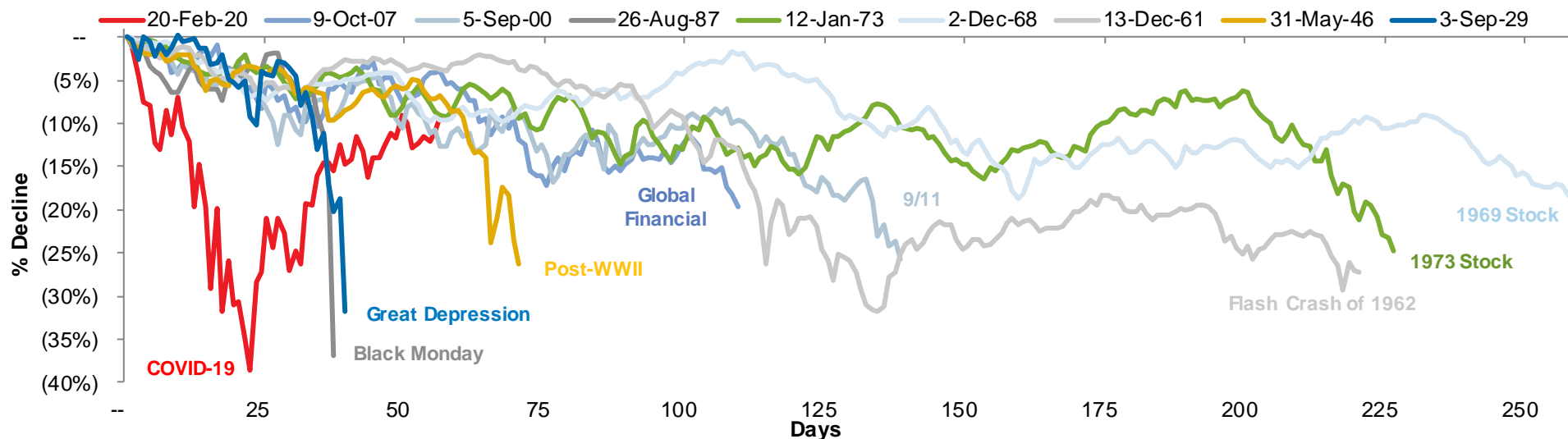
Lyle Wilpon

Global Head of Advisory

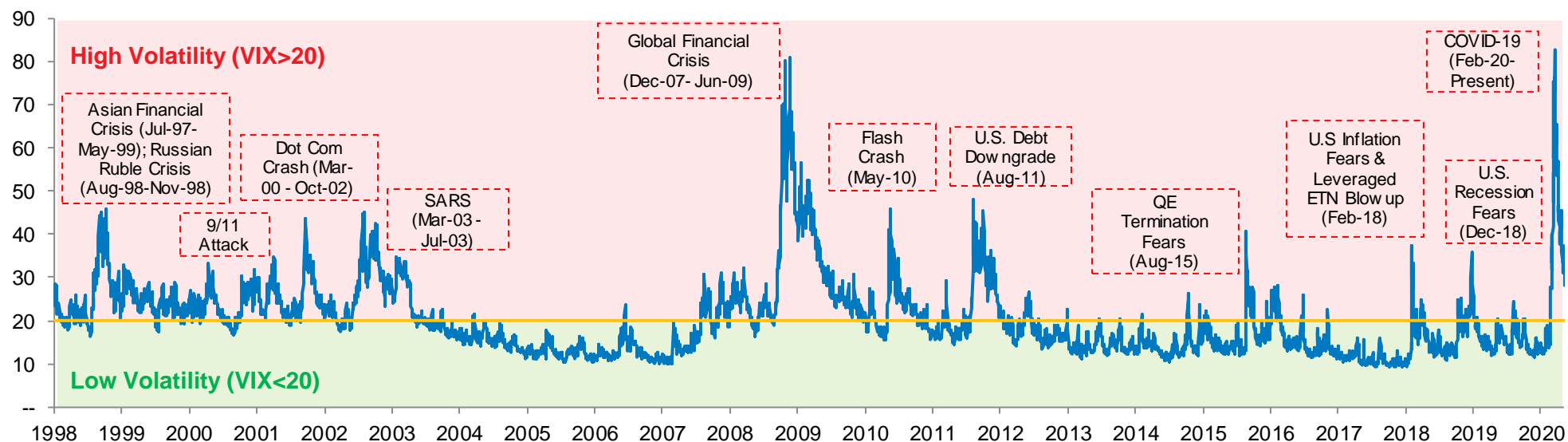


# Unprecedented Impact on Global Equity Markets due to COVID-19

TRAJECTORY OF HISTORICAL 20%+ DRAWDOWNS OF S&P 500 SINCE 1920<sup>(1)</sup>



CBOE VOLATILITY INDEX (VIX)



Source: FactSet

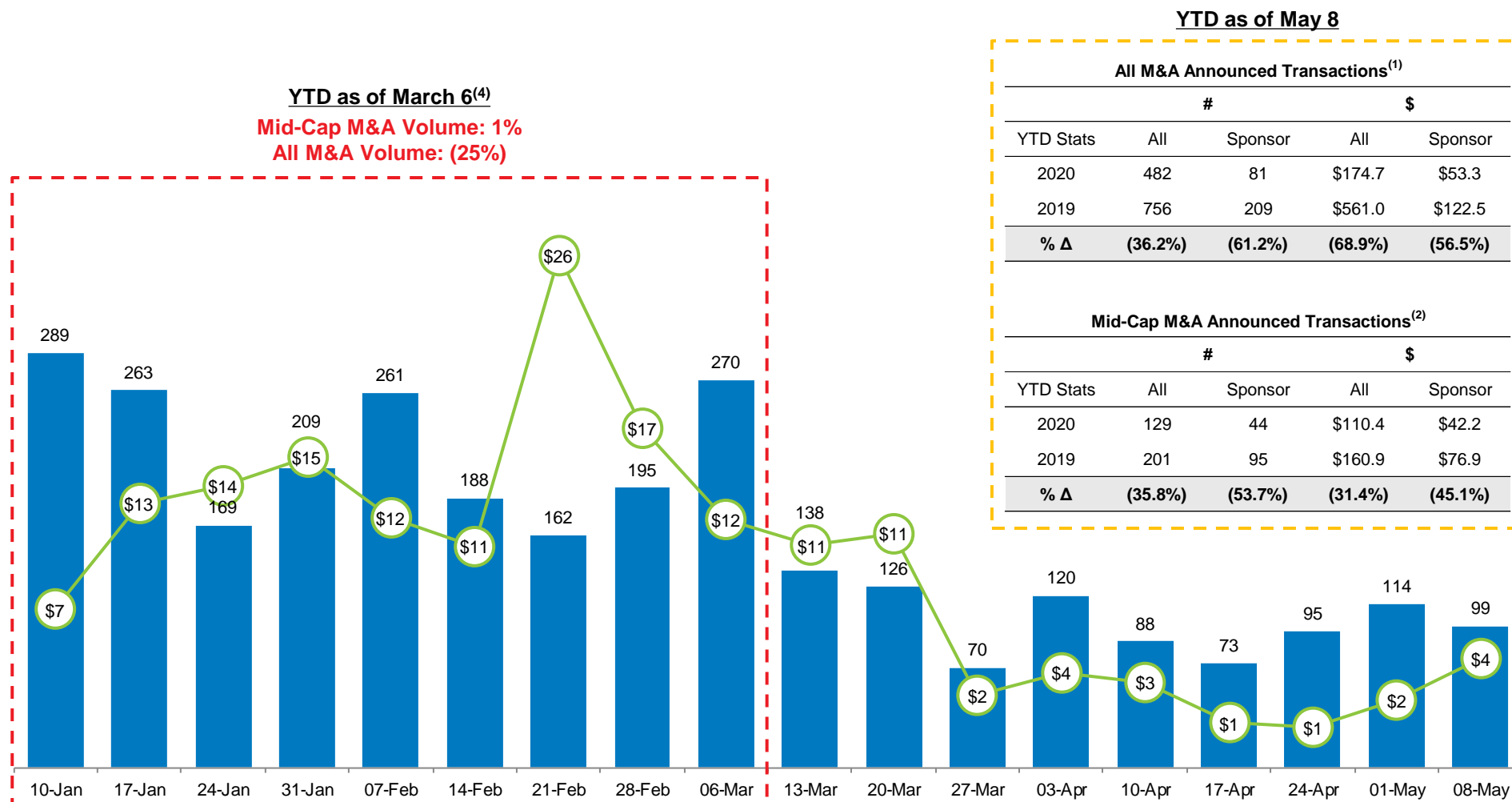
Note: Market data as of 08-May-2020.

1. COVID-19 crisis dates range from 20-Feb-2020 to 08-May-2020.

# Driving Disruption and Declines in M&A Activity

WEEKLY ANNOUNCED M&A TRANSACTIONS<sup>(3)</sup>

Transaction Volume      Disclosed Transaction Value (\$bn)



Total disclosed transaction value since the week ending March 13 is down 89% from the same period in 2019

Source: BMO Estimates, FactSet

Note: Market data as of 08-May-2020.

1. Includes all publicly disclosed deals with transaction values since 01-Jan-2020.
2. Includes deals with publicly disclosed transaction values between \$200 and \$5,000 million since 01-Jan-2020.
3. Includes all complete and pending announced M&A transactions with U.S. targets.
4. Percentage change over the same period in 2019.

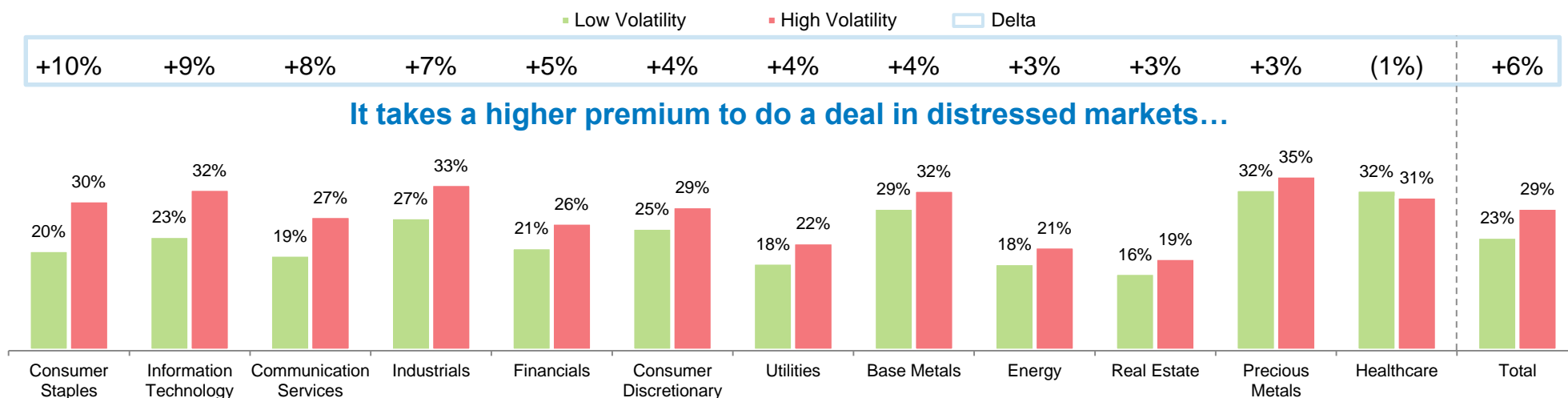
## Key Themes Driving the Shift in M&A Dynamics



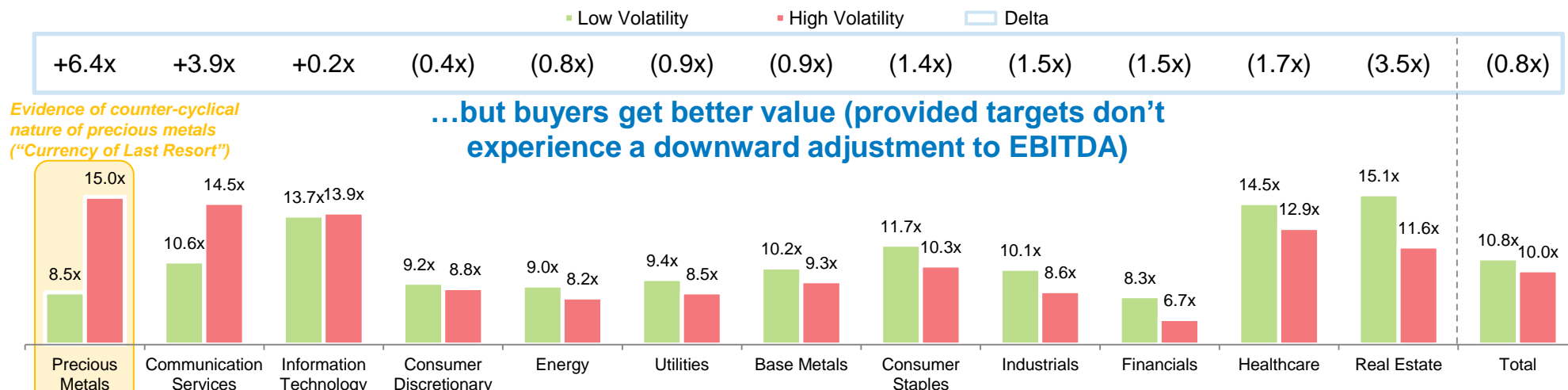
# Impact on Transaction Premiums and Multiples During Distressed Markets

From 1998 to Present

## TRANSACTION PREMIUMS<sup>(1)</sup>



## PURCHASE PRICE MULTIPLES (LTM)<sup>(2)</sup>



Multiples for high volatility periods skewed by historically high M&A multiples paid during the period of high market volatility preceding the Dot Com Bubble

Source: FactSet

Note: The CBOE Volatility Index (VIX) is used as a proxy for equity volatility; 'low volatility' defined as periods with VIX levels below 20 and 'high volatility' defined as periods with VIX levels above 20.

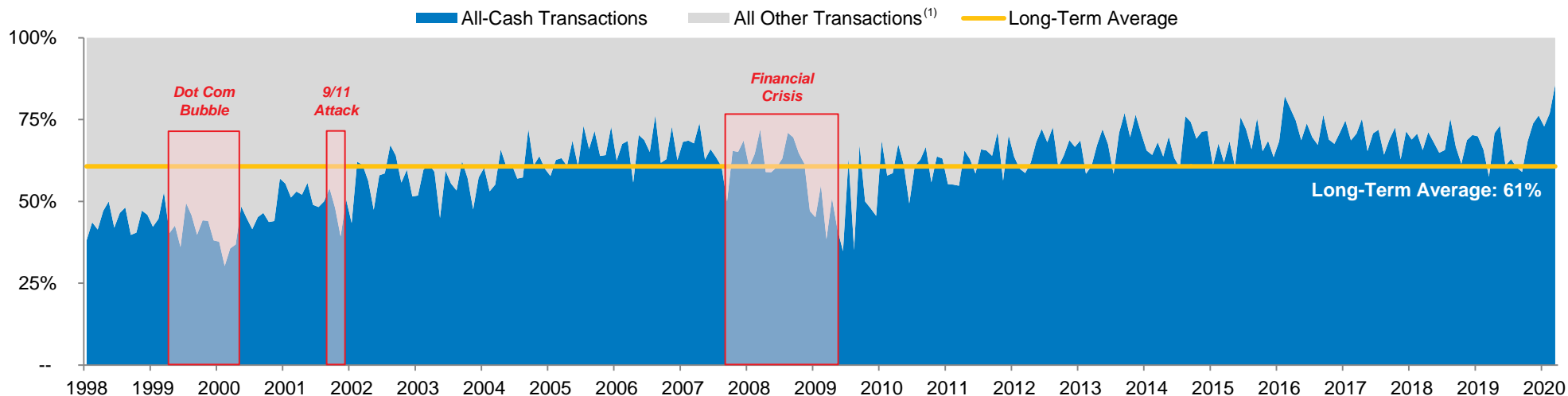
1. Median one-day premium paid for North American transactions over \$50mm from 1998 to present.

2. Median EV / LTM EBITDA multiple paid for North American transactions over \$50mm from 1998 to present; transactions with multiples over 50x EV / LTM EBITDA are excluded.

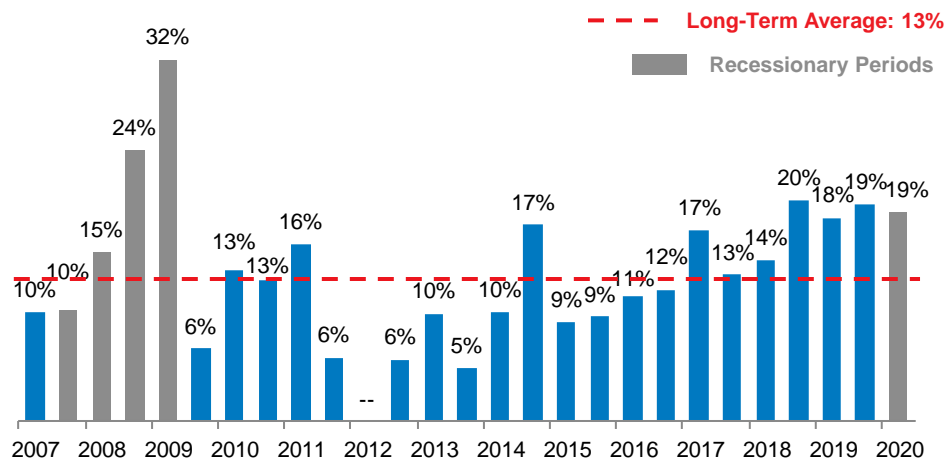
# Driving More Usage of Stock as a Form of Transaction Consideration

From 1998 to Present

## TRANSACTION CONSIDERATION<sup>(1)</sup>



## ALL-STOCK DEALS



## OBSERVATIONS

- The likelihood of an all-cash transaction is negatively impacted by an increase in equity volatility
- All-cash deals are more likely in low volatility markets (65% of transactions) vs high volatility markets (53% of transactions)
- In a distressed environment, target shareholders may view a stock-based transaction as more favorable due to relative valuation consideration given:
  - Debt financing is often not readily available
  - Buyers are often more hesitant to deploy balance sheet cash given the uncertainty of future cash needs
  - The buyer and seller relative valuations are likely to be impacted similarly by market swings

Cash scarcity and absolute valuation issues lead to fewer all-cash transactions in periods of market dislocation

# And Increases in Protection Clauses and Covenants in M&A Agreements

## INTENSE SCRUTINY ON MAC CLAUSES AND CARVE OUTS

- Prior to COVID-19, pandemics, epidemics and similar terms were rarely explicitly included as a carve-out to a material adverse change (“MAC”)
- Since COVID-19, there has been a sharp increase in explicit carve-outs for pandemics, epidemics or similar health emergencies
- A buyer faces a heavy burden to enforce an MAE clause in order to avoid the obligation to close

## FOCUS ON COVENANTS AND IMPACT OF NON-COMPLIANCE

- Covenants require the target to continue operations in the ordinary course of business and, without buyer’s consent, refrain from certain actions
- Increased questions and scrutiny on what is ordinary course in light of the current COVID-19 environment
- Sellers should negotiate for operational flexibility, including exceptions to address the coronavirus

## ANTICIPATION FOR DELAYS IN CLOSING

- All deals should anticipate delays between signing and closing (e.g. regulatory, change-of-control, shareholder meetings, etc.)
- While recent agreements have not included constructs on extending the outside date due to delays, expect to see extension mechanisms similar to those during the U.S. government shutdown in 2019
- Future merger agreements should consider appropriate mechanisms to allocate risks of delays in closing

## REAL-TIME SITUATIONS



- On April 22, Sycamore Partners filed a lawsuit to back out of its deal to take over Victoria’s Secret from L Brands
- Sycamore stated that L Brands violated the transaction when it closed its stores and skipped rent payments in April
- The parties ultimately settled all pending litigation and released all claims without a termination fee



- On April 2, Bed Bath & Beyond asked a judge to hold 1-800-Flowers.Com to a \$252mm deal between the companies
- The sale agreement does contain a MAC though the company has not invoked it yet

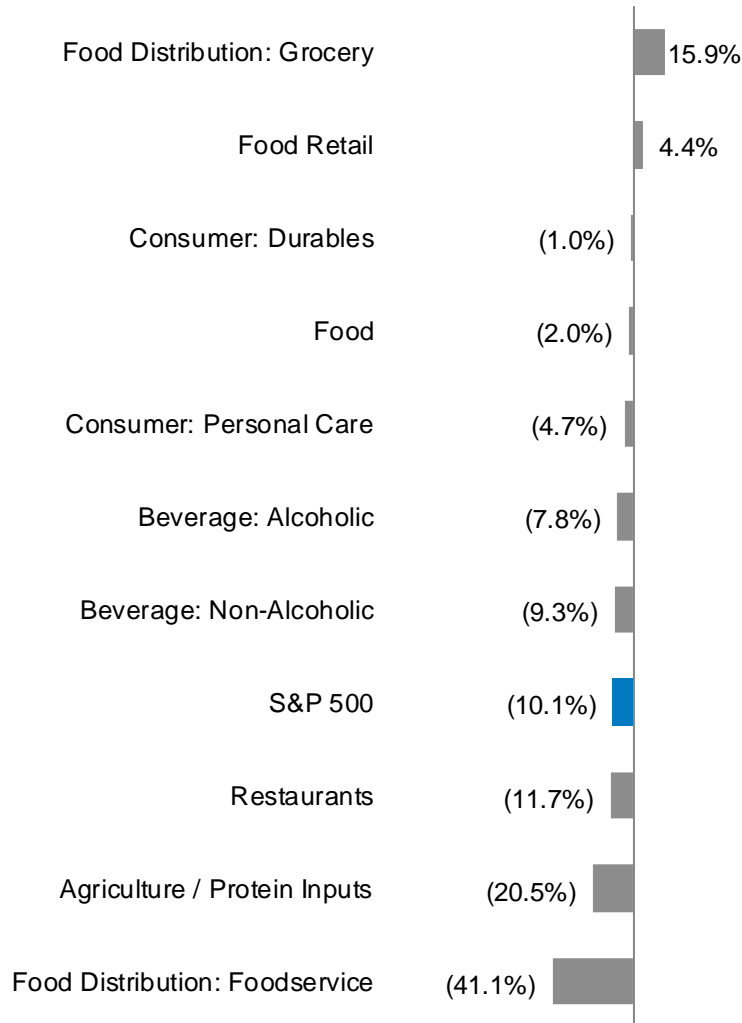
**Allegro Merger Corp** /



- On April 6, Allegro Merger, a shell company that agreed to take the casual-dining chain public in a reverse merger late last year, opted to back out of the deal and return money to shareholders
- Allegro cited “extraordinary market conditions and the failure to meet necessary closing conditions

# Within FCR, Trends are Correlated to Degree of Exposure to COVID

## YTD FCR SUBSECTOR PERFORMANCE



## KEY M&A TRENDS ACROSS THE FOOD, CONSUMER AND RETAIL LANDSCAPE

### 1 WELL-CAPITALIZED BUYERS COMPLETING SELECT LATER-STAGE / BOLT-ON M&A

- Some transactions remain on track to close, however activity is generally limited to late-stage, strategic, and bolt-on situations
- New activity generally limited to one-off discussions and pre-process introductions



COTY / KKR

### 2 CHALLENGED COMPANIES GETTING NEAR-TERM RELIEF FROM PRIVATE EQUITY

- With depressed stock prices and a record amount of dry powder, PE firms have made backstop investments in companies with near-term liquidity needs
- Varying degrees of 'need' – some are taking incremental capital to fund future growth



### 3 DISTRESSED SITUATIONS DRIVING ACTIVISM, LAWSUITS, AND RESTRUCTURINGS

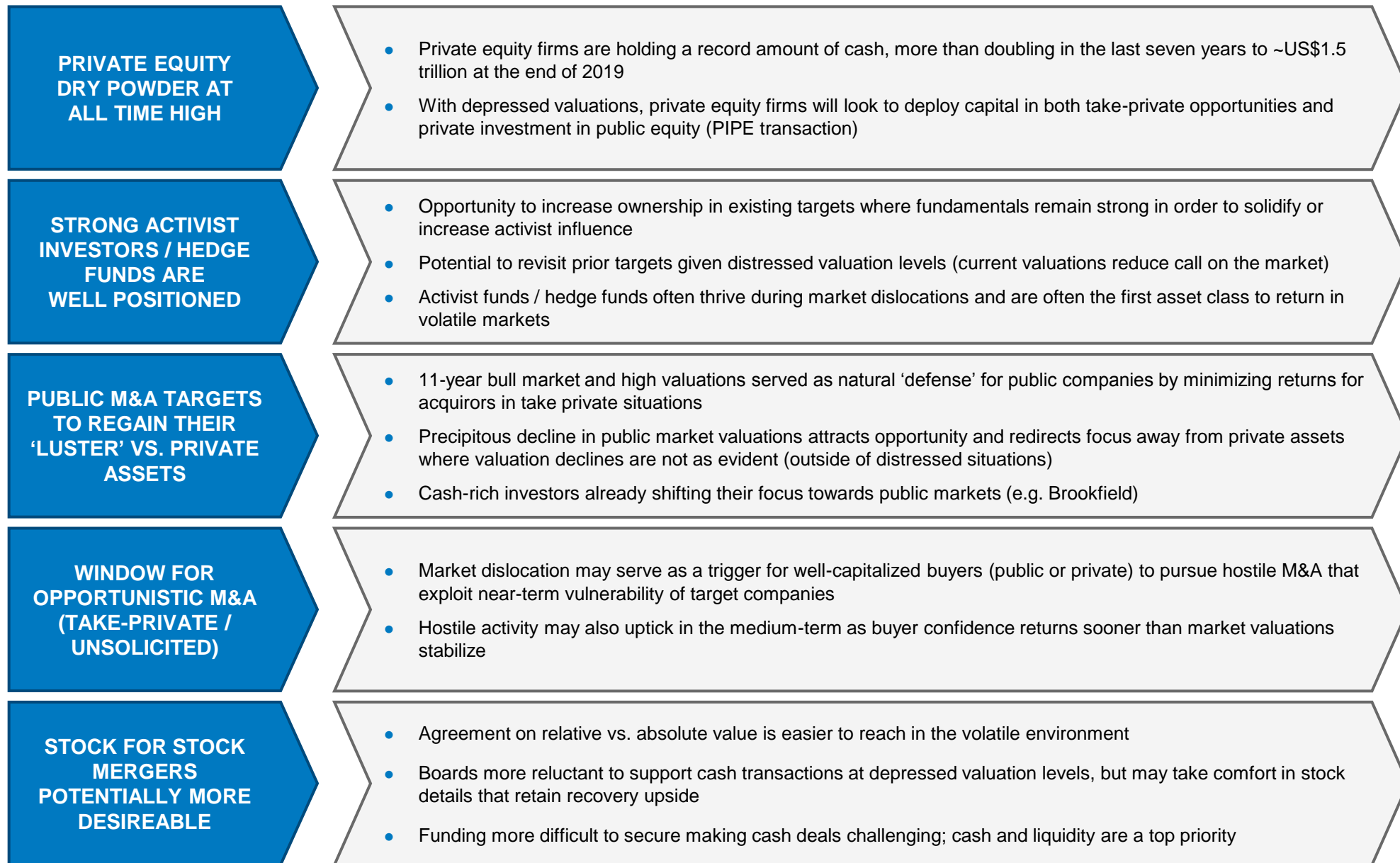
- A prolonged pandemic is exacerbating challenges for some, prompting activism and forcing certain companies into chapter 11
- Some deals have seen lawsuits filed by buyers looking to exit out of previously announced M&A



Until there is more clarity on the severity and duration of the Coronavirus impact, it is difficult to envision transformative M&A transactions in the near term

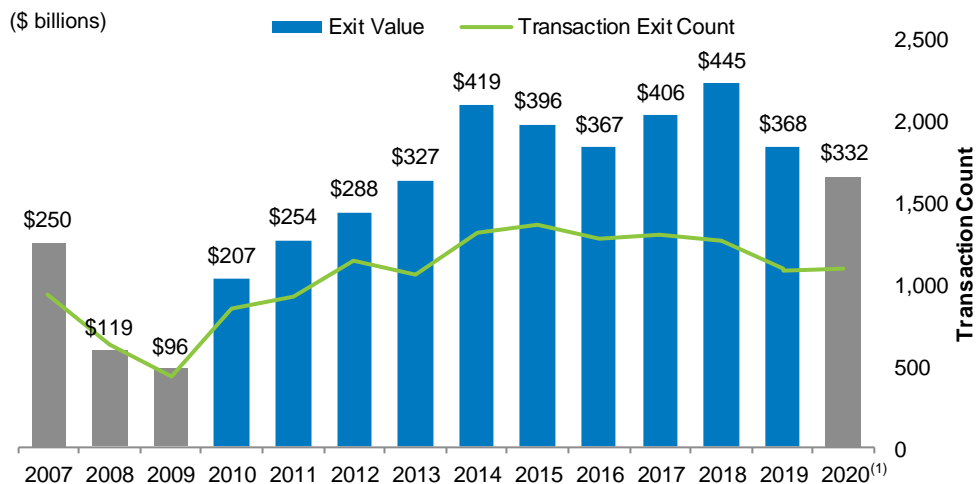


## Looking Forward, Key Themes Expected to Drive M&A Activity



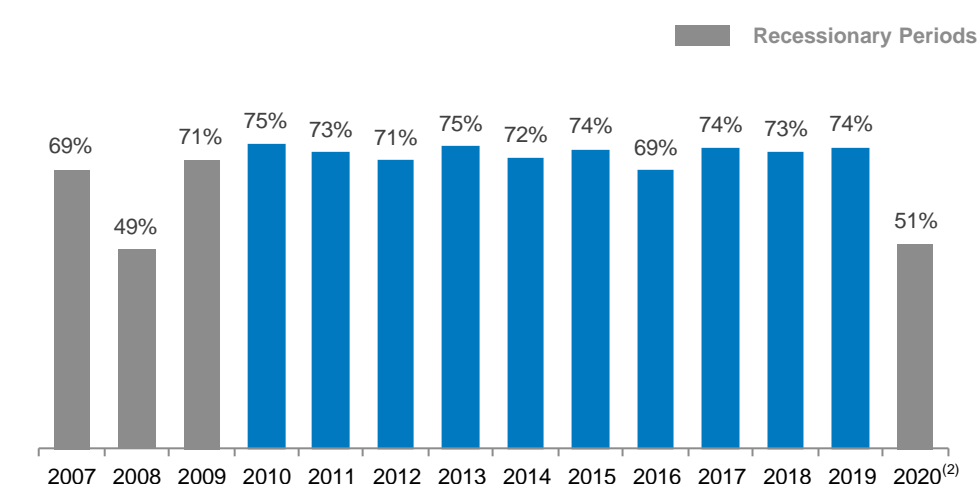
# PE Standing Ready, with Capital Available, Seeking Take Private Opportunities

## U.S. SPONSOR EXITS



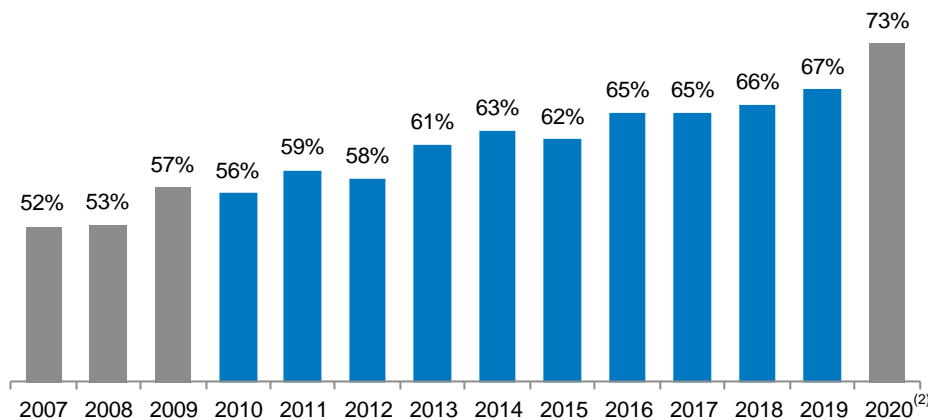
The quantity and value of sponsor-owned company exits tend to decrease during recessionary periods

## PERCENTAGE OF ALL U.S. SPONSOR EXITS WITH >\$500MM IN TEV



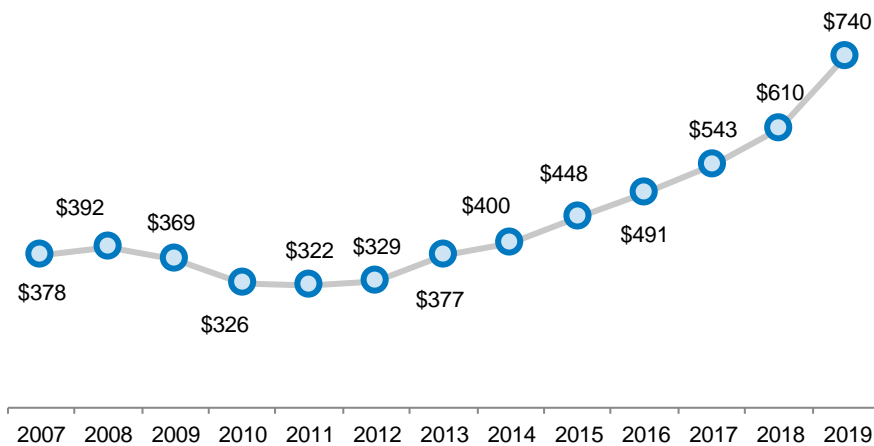
Sponsors are less likely to sell larger portfolio companies during recessionary periods

## ADD-ONS PERCENTAGE OF U.S. SPONSOR BUYOUTS



Sponsors are more likely to deploy capital on add-ons than on platforms during recessionary periods

## U.S. PRIVATE EQUITY DRY POWDER



Take-private opportunities and PIPE transactions expected to occur in the near-term as companies are seeking liquidity

9 Source: Pitchbook  
 Note: Data as of 31-Mar-2020; Dry powder data as of 30-Jun-2019.  
 1. Last four quarters as of 31-Mar-2020.  
 2. Year to date as of 31-Mar-2020.

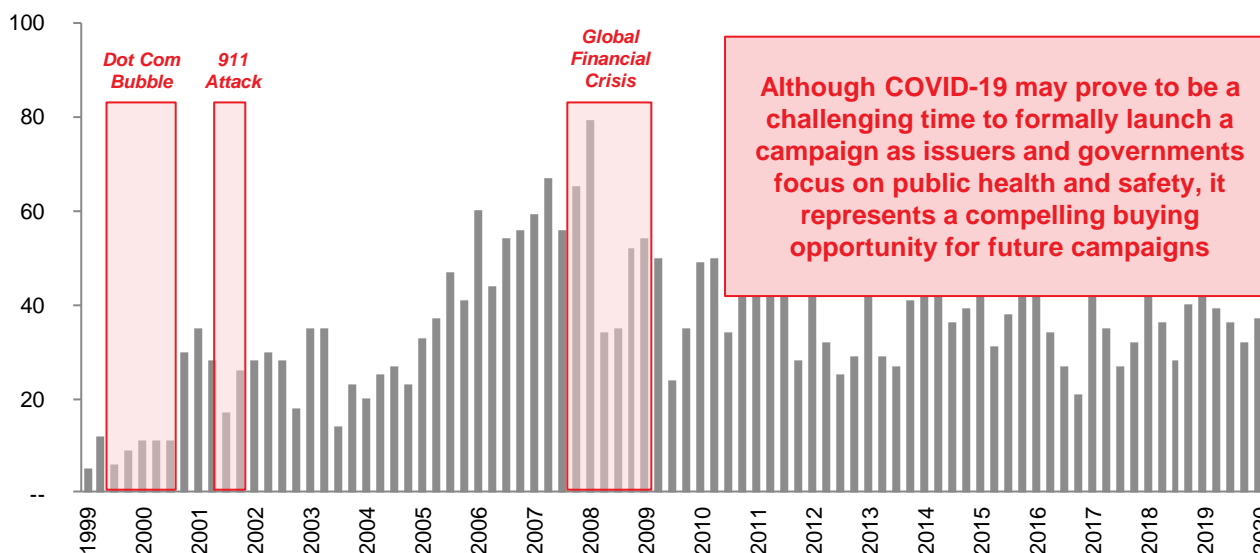
# Activists Likely to Pursue Distressed Targets, Driving an Increase in Poison Pills

From 1999 to Present

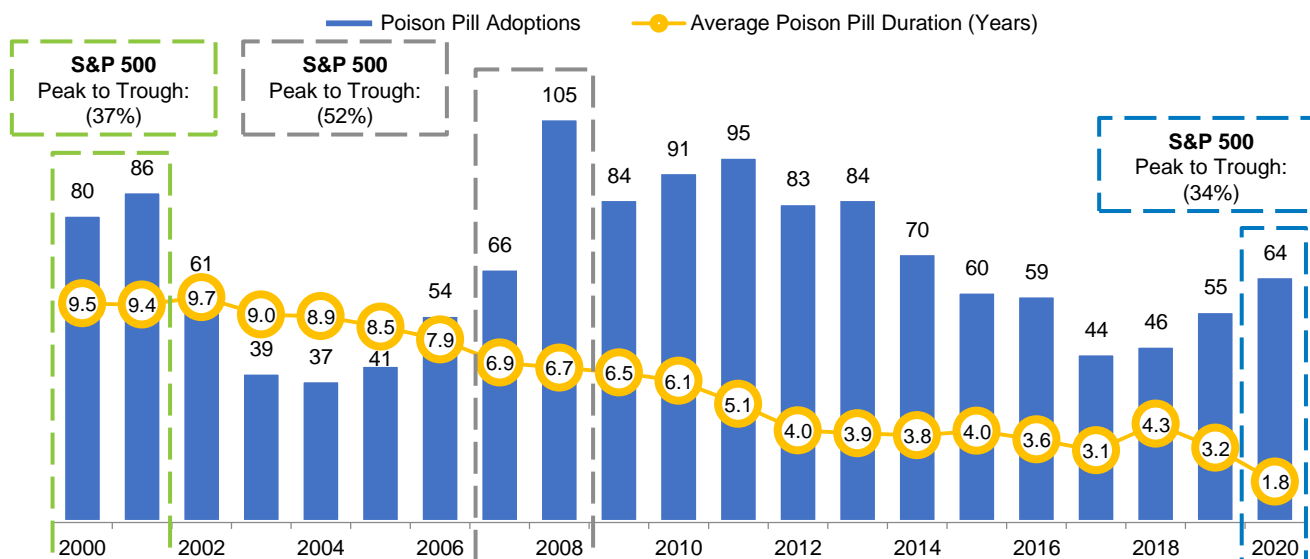
## OBSERVATIONS

- Although there is no empirical evidence of a surge in activist campaigns during market dislocations, activists typically use this period to gain footholds in attractive targets at distressed valuations
- The global financial crisis saw a drop in publicly announced activism campaigns, as activists generally remained on the sidelines
  - Many hedge funds faced margin calls and impaired portfolios
  - Activists with dry powder can use crisis windows as an opportunity to establish footholds for future campaigns
- On a relative basis, when all sectors are down, activists are less inclined to push for changes
  - A break-up strategy becomes difficult as it relies on achieving a premium valuation for a specific asset / division which may be difficult in an environment with few buyers
- Since mid-March there have been 50 shareholder rights plans ("Poison Pills") adopted
  - There has also been a resurgence of NOL poison pills similar to during the financial crisis in 2008
  - Similar to traditional a poison pill except it is triggered at lower shareholder ownership levels, typically ~5%

NUMBER OF PUBLIC ACTIVISM CAMPAIGNS<sup>(1)</sup>



NUMBER OF SHAREHOLDER RIGHTS PLAN ADOPTIONS<sup>(2)</sup>




Source: FactSet, Activist Insight




1. Public campaigns launched against Canadian and U.S. targets since 1999.
2. 2020 shareholder rights plan adoption data as of 08-May-20.

# Recent FC&R Activism Campaigns and Shareholder Rights Plan Adoptions

## RECENT ACTIVISM CAMPAIGNS

	<u>% Change in YTD Share Price<sup>(1)</sup></u>
	NAS: BLMN (49.2%)
	NYSE: CMG 10.6%
	NYSE: GNC (79.3%)
	NYSE: MCD (8.3%)
	NAS: PPC (34.9%)
	NYSE: TJX (20.6%)

## RECENT SHAREHOLDER RIGHTS PLAN ADOPTIONS

	<u>% Change in YTD Share Price<sup>(1)</sup></u>
	NAS: CHEF (64.2%)
	NYSE: CHS (64.0%)
	NAS: PLAY (71.4%)
	NYSE: EXPR (63.0%)
	NYSE: SIX (53.0%)
	NYSE: HGV (44.5%)

## Key Indicators of a Broader Re-Start

### BEGINNING OF SOCIAL DISTANCING EASING

- U.S. starts to reopen the economy as states begin to phase out of stay-at-home orders
- Loosening of restrictions will allow for businesses see more foot traffic, as well as allow for overall business travel and in-person diligence

### UNEMPLOYMENT REDUCTION

- As the economy begins to reopen unemployment claims are likely to taper off
- As unemployment begins to stabilize, consumer discretionary income spending to reverse over time

### CREDIT MARKET STABILIZATION

- Throughout April, credit markets overall have grown more stable, supported by the Fed and Government backed economic-recovery packages
- Broader availability of acquisition financing key to giving sellers conviction to 're-start' processes

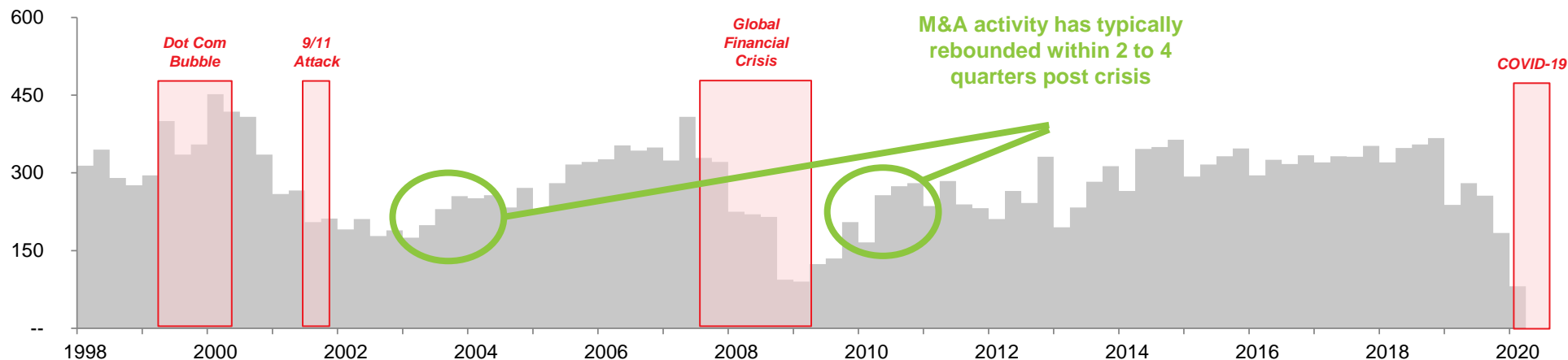
### PREDICTABILITY OF AND CONFIDENCE IN SELLER PROJECTIONS

- A gradual reopening of the U.S. economy may stabilize unpredictable consumer spending and alleviate supply chain disruptions
- Increased consumer consumption may normalize purchase behavior back to pre-COVID patterns

# Assessing the Potential Length Until Sustained Recovery

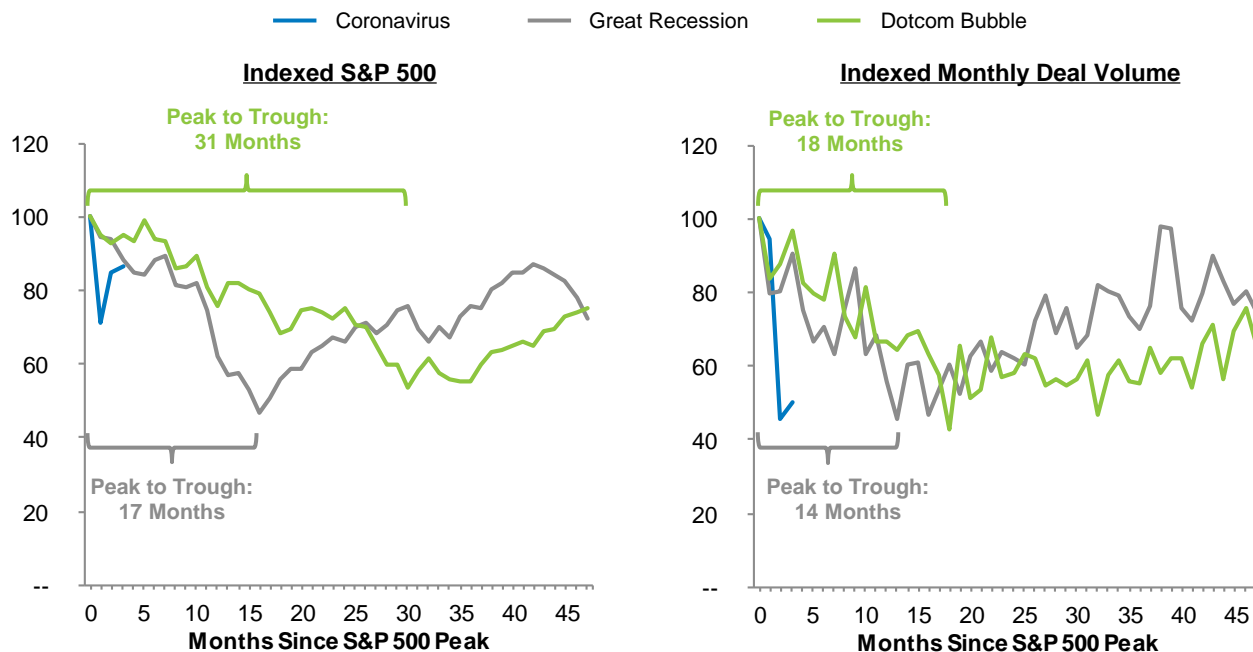
From 1998 to Present

DEAL VOLUME BY QUARTER<sup>(1)</sup>



INDEXED TRENDS DURING PAST RECESSIONS<sup>(3)</sup>

- The Coronavirus crisis has impacted the markets much faster relative to the last two major recessions:
  - The recent S&P 500 decrease is consistent with the drop that was experienced after approximately one year during the Great Recession and after approximately two years during the Dotcom Bubble
- However, U.S. equity markets have been surging for the last three weeks, driven by the combined efforts of the government and Federal Reserve to pull the economy out of choppy waters
- Deal volumes have historically been impacted more rapidly than the S&P 500 by the downturns; however, they also have recovered more rapidly
  - Approximately six months after the market peak prior to the Great Recession, deal volumes were down ~33%, compared to ~15% on the S&P 500, though they returned to the original peak levels a little over three years later



# How Can Companies Prepare?

## DEFENSE

### Activism Defense

- Activism is on the rise in the U.S., especially heading into AGM's
- Assemble a team to establish a defense plan
- Monitor and engage shareholder base
- Carry out regular vulnerability checks

### Hostile Defense

- Mitigate time advantage by preparing organizational actions today
- Involve the Board and engage investor base (more likely to succeed with supportive shareholder group)
- Revisit a shareholder rights plan (U.S.)

### Preserve Balance Sheet

- Streamline operations to preserve cash flow
- Revisit capital programs and dividend distributions

### Proactively Seek Strategic Investments

- Companies in need of cash can potentially benefit from an investment from either private equity or strategic (white squire defense)
  - Customary standstill and governance to align company and investor

## OFFENSE

### Maintain Diligence Efforts

- For auctions that are still ongoing, continue engagement and diligence efforts but potentially lower purchase price
- For transactions with fundamental business rationale, create preemptive discussions from auctions that have hit the pause button

### Reassess Previous Targets

- Reassess if previous targets continue to have strong fundamental rationale
- Attractive targets that were previously contemplated may be vulnerable and are more likely to transact

### Approach New (Weaker) Targets

- Opportunity to acquire or invest in targets with strong fundamentals / outlook if they are facing near-term liquidity constraints or issues

### Preserve Liquidity for Future M&A

- Preserving cash and maintaining low leverage positions buyers to be nimble and acquisitive in this market or when uncertainty subsides

Boards and management teams should assess company's current situation and adopt defensive and/or offensive measures in response to the crisis

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