Baker Tilly International–Acuris thought leadership campaign

Global dealmakers: Asia-Pacific M&A market update 2020

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Contents

Methodology

From July to August 2020, Baker Tilly International commissioned Acuris Studios, the publishing division of Acuris, to canvas the opinions of 60 dealmakers to gauge their opinions on M&A opportunities, trends and challenges in Asia-Pacific. Respondents were evenly split and based in the following regions: Asia-Pacific, North America and Europe.

Within the graphed survey results, percentages may not sum to 100% due to rounding, or when respondents were allowed to choose more than one answer. All quoted data is propriety Mergermarket data unless otherwise stated. All deals are based on announced transactions.

Foreword

Global M&A is in decline as the effects of COVID-19 continue to be felt across the global economy – however, Asia-Pacific offers a glimmer of hope and opportunity for corporations and private investors.

First to feel the pains of COVID-19, Asia-Pacific may be one of the first regions to rebound in a post-pandemic world. Such is the sentiment among dealmakers in our research focused on M&A in the region, where 58% say an economic recovery will come sooner and swifter than in North America and Europe. This would be good news as year-to-date M&A in Asia-Pacific hits new lows, although remaining noticeably higher than global declines.

Indeed, large numbers of dealmakers are optimistic about Asia-Pacific's prospects for the remainder of 2020 and early 2021. More than a third (38%) say Asia-Pacific has better M&A opportunities than other regions and another 37% say they will be increasing investment here in the year ahead.

Dealmakers point to numerous advantages the region has over more developed markets: primarily positive valuations that have strengthened deal activity in addition to a burgeoning mid-market and tech opportunities. Emerging markets across the region offer ample investments, with respondents pointing to Southeast Asia as the primary market where dealmakers will focus their attention. Advanced markets like Australia will also remain priority target markets for investors looking for more mature markets with stronger fundamentals.

Many dealmakers also feel there is ample room for consolidation within industries, much more so than perhaps in Western markets. However, others feel that geopolitics and the impact of the ongoing US-China trade war will be a dominant force influencing deal trends. In fact, many dealmakers view geopolitics as one of the top challenges they face, especially in the run-up to the US presidential election in November. Likewise, many respondents are concerned that political issues and matters of national security could impact or interrupt potential deals for them in the near term.

This latest issue of our 'Global Dealmakers: Cross-border M&A outlook' series looks at these issues and others likely to impact dealmaking in Asia-Pacific. As with past publications, we returned to the market to ask questions about investment intentions and views on the M&A market. The feedback from dealmakers has helped paint a vivid picture of the trends and challenges shaping the deal landscape, as well as the drivers and market factors where opportunities are waiting to be discovered.

"Asia was the first region to be impacted by COVID-19 but it was also the region that has best weathered the subsequent months. Indeed, the high-growth prospects of emerging Asia and the stability of the more established economies have underpinned confidence among dealmakers. Our latest report highlights the sectors and areas in which dealmakers see opportunities for M&A going forward. The uncertainty created as COVID-19 spread across the globe, forcing governments to shut down, saw owners focussing intensely on their businesses. Initially this focus was about survival, but once the storm passed, this deeper understanding has led to busines owners and managers to consider the use of M&A to accelerate growth. The insights developed through the crisis are likely to drive higher levels of M&A activity into the future."

Michael Sonego, Partner, Pitcher Partners Australia, Global Corporate Finance Lead, Baker Tilly International

Key findings

37%
of dealmakers say they will increase investments into Asia-Pacific in the year ahead

38%
say Asia-Pacific has better M&A opportunities than other global markets

58%
say Asia-Pacific will have a quicker economic recovery than North America and Europe

2,671
M&A deals completed in Asia-Pacific in Q1-Q3 2020, a decline of 14% from Q1-Q3 2019

US$567bn
in total M&A deal value in Q1-Q3 2020, an increase of 31% from Q1-Q3 2019

38%
say industry consolidation will be the top driver of M&A

Responding to regulations and geopolitical events (58%)
will also drive dealmaking

90%
say Southeast Asia has the most M&A opportunities within Asia-Pacific

Australia and India
also rank as top markets for M&A, according to 63% of respondents

43%
say matters of national security will impact or interrupt potential deals in the year ahead

55%
say private equity activity will increase in Asia-Pacific in the year ahead

42%
say private equity funds in Hong Kong will begin relocating elsewhere in Asia-Pacific given recent changes to the city-state's security laws

M&A in Asia-Pacific: **Q1–Q3 2020 review and outlook**

Asia-Pacific may be weathering the storms of pandemic and macroeconomic uncertainty better than global markets. Recognizing the region's resilience, dealmakers are confidently targeting the region for future M&A.

In line with global trends, M&A in Asia-Pacific posted a noticeable slowdown in 2020 as the ongoing pandemic and subsequent economic volatility and uncertainty takes its toll. The number of deals in Q1-Q3 2020 declined 14% (2,671 deals) from 2019 (3,092 deals). On a quarterly basis, the decline was somewhat sharper, dropping 17% in Q3 2020 (893 deals) compared to Q3 2019 (1,074 deals).

Deal value trends, on the other hand, have swung in the opposite direction. In Q1-Q3, M&A values across Asia-Pacific rose 31%, with US$567bn in deal dollars compared to US$433bn in the same timeframe in 2019. These totals were influenced heavily by several megadeals, involving Chinese energy companies and Japanese tech corporations, that made up 22% of values for the year to Q3.

Figure 2. Which of the following best describes your intentions with regard to investing/M&A into Asia-Pacific in the year ahead?

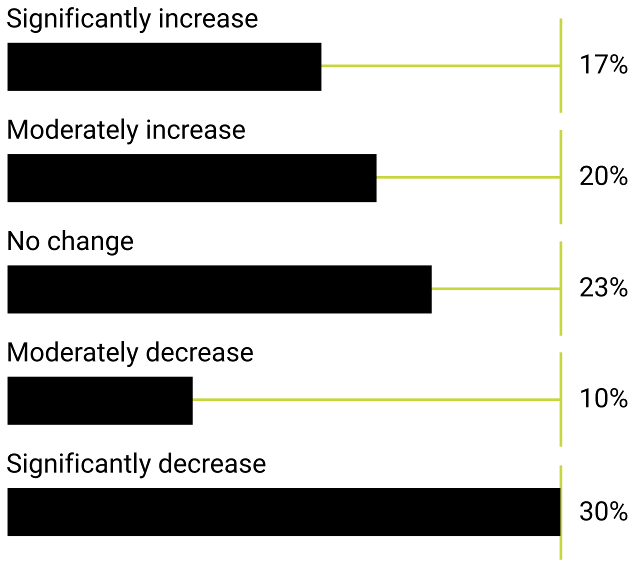


Figure 1. Asia-Pacific M&A trends

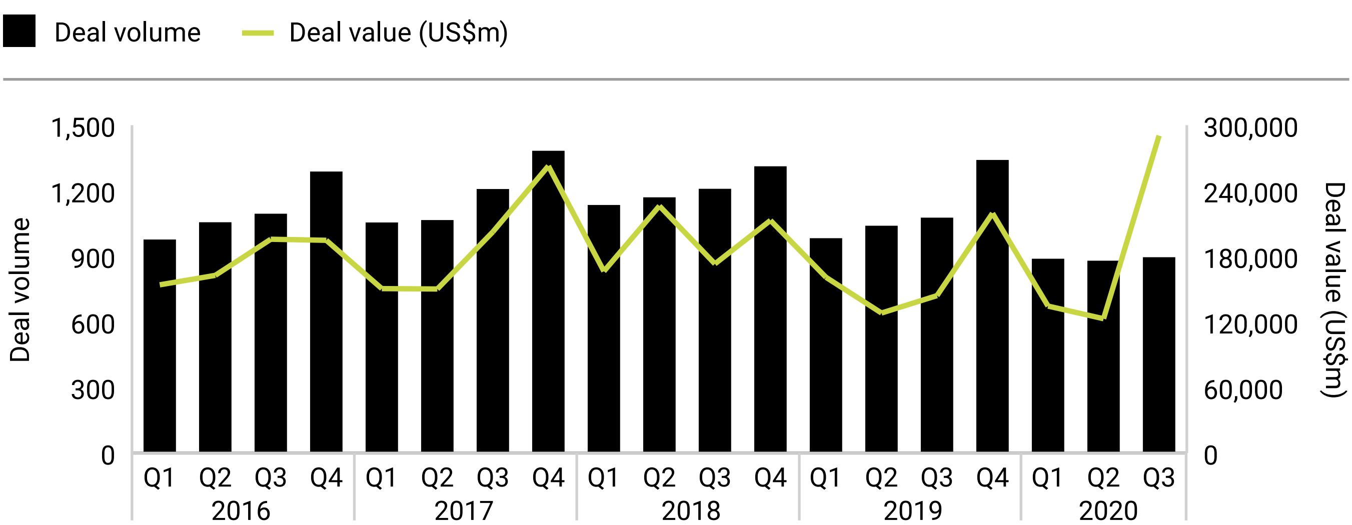
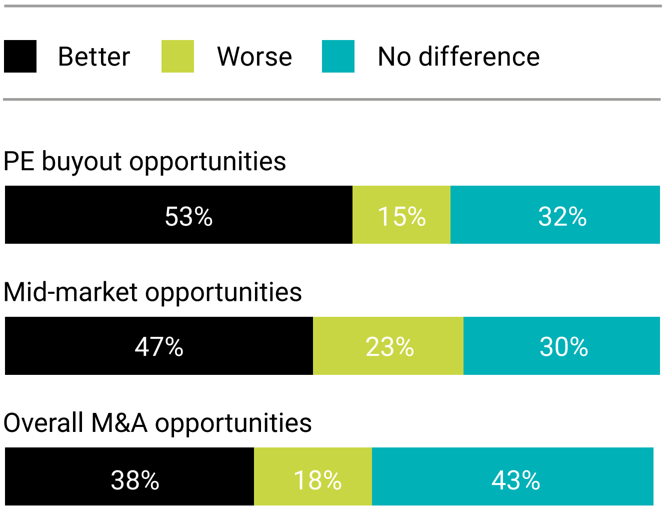


Figure 3. Generally, do you feel Asia-Pacific offers better or worse M&A opportunities compared to other regions?



"Although the deal activity in Asia-Pacific has generally slowed in the current economic environment, we can still see an increase in activity in certain sectors. The current situation presents opportunities for those willing to build the right foundation. The question is, what are the right projection numbers to consider in order to complete the deal flow in this time?"

Andrew Heng, Group Managing Partner, Baker Tilly Malaysia

While some dealmakers may be confident in the current environment, overall sentiments seem to reflect a certain degree of caution, with 40% saying they will likely decrease investment into Asia-Pacific in the year ahead. However, noticeably high and similar numbers (37%) say the region holds promise and that they will be increasing their M&A efforts. Another 23% say they will stay the course with deals, keeping M&A at current levels.

Regardless of their intentions, respondents (38%) agree that M&A opportunities in Asia-Pacific are better than other global markets. Another 43% say they are equal to similar investments elsewhere in the world and would produce equally promising returns.

Echoing sentiments shared by the wider body of respondents, one dealmaker says, "Generally, Asia-Pacific offers better opportunities. There is faster growth and the valuations are also reasonable. The targets in the region have a mostly successful track record and we can rely on consistent growth." Another goes on to say that "Investors can undertake M&A decisions confidently. In other markets, there is more uncertainty to consider."

Asia-Pacific's advantages

Dealmakers highlight Asia-Pacific's numerous advantages, particularly when compared to more advanced economies in North America and Europe. For these reasons and others, sentiment toward cross-border M&A within Asia-Pacific has remained strong even against the backdrop of the COVID-19 health crisis: 62% say the pandemic will have limited impact on their international investment strategies regarding Asia-Pacific.

Valuations

In addition to there being more and better opportunities in Asia-Pacific, dealmakers also feel these transactions are more reasonably priced. According to one respondent, "The acquisition premiums are lower than other markets. [Corporations] can avail more profitability by investing in Asia-Pacific markets than elsewhere." Another says, "Target valuations are feasible and there is a smaller valuation gap, with sellers and buyers being particularly efficient in ensuring the preparedness for deals. Although the markets are competitive, expected valuation goals can be met."

Valuations were also one of the main reasons more than half of dealmakers (53%) feel buyout opportunities are greater in Asia-Pacific, even compared against overall M&A opportunities. According to one respondent, “For carve outs and buyouts, valuations are lower, even with the increasing competition for targets.”

Mid-market

Asia-Pacific’s diverse and growing mid-market (deals valued between US$10m and US$250m) has been a beacon for investors. Almost 78% of deals with disclosed values in Asia-Pacific fall in this segment of the M&A market. More importantly, close to half of dealmakers (47%) say the region’s mid-market opportunities are better than global markets.

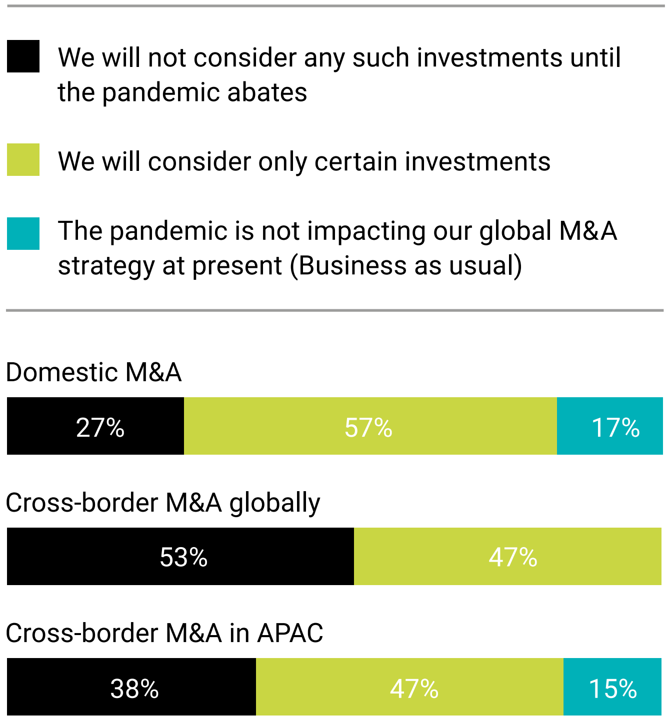
According to respondents, the rise of middle classes across the region have allowed mid-market firms to grow in step, achieving higher revenues and expanding their reach. Even amid the ongoing pandemic, mid-market firms are proving their resilience. According to one respondent, the mid-market offers “better growth potential” than small-cap or bulge bracket deals and that, post-deal, “integration is faster and smoother because it’s easier to train staff and automate processes seamlessly.”

Other respondents praise another quality of mid-market firms: uptake of new tech to sharpen their competitive edge. Within the Asia-Pacific’s mid-market, “the adoption of technologies is faster, which means we do not need to spend more post-acquisition. There are just a few enhancements that we make and we can expect higher returns,” says one respondent.

Tech opportunity

Dealmakers also say that the adoption of the latest technologies and digital innovation is much faster among Asia-Pacific businesses than other markets, with one respondent saying that this “means we don’t need to spend more post-acquisition. There are just a few enhancements that we make and we can expect higher returns.” Another goes on to say that “even during recessions, the tech and telecom markets have been flourishing” as many such businesses thrive even given the challenges of operating during a pandemic.

Figure 4. How has COVID-19 impacted your cross-border M&A strategy with regard to Asia-Pacific and globally?



Within Asia-Pacific, technology, media and telecommunications (TMT) M&A accounted for 17% of deals and 21% of values (463 deals worth US$121bn) in Q1-Q3 2020. This was second only to industrials and manufacturing (20%) in volume and energy and mining in value (23%) and is in line with historical trends where tech deals have accounted for a larger share of acquisitions in the region.

According to respondents, tech deals open up opportunities to transform the enterprise, either by building on an acquisition target or using the purchase to strengthen already existing operations and processes. They can also enable companies to expand across business or product lines into new markets.

Economic recovery

Dealmakers are also confident that Asia-Pacific’s economic resilience will prevail and lead to a quicker, and possibly stronger, recovery than markets in North America and Europe. More than half of respondents

(58%) anticipate such rebounds. According to one respondent, "Asia-Pacific will see a quicker recovery, because central banks are taking the initiative to alter interest rates and stabilize the economies. In other markets, I feel that there are more barriers due to political differences."

However, there is still pessimism within the ranks. Despite quick action to contain the pandemic, regional markets have still been hit by the shock of shutdowns to their economies. Many respondents say that while the situation in Asia-Pacific is better compared to global markets, particularly the US, there is still significant room for improvement. Echoing this reality and in line with the 33% of respondents who challenge the idea that the region's economic recovery will be quicker, one respondent says, "The impact of COVID-19 on job markets and the continuity of businesses will not allow the recovery to be swift or without challenges."

Global M&A: The big picture

Almost 10 months since the outbreak of COVID-19, the full impact of the pandemic on M&A markets is starting to be seen. Globally, deals have dropped precipitously, posting 10,975 deals valued at US$1.8tn in Q1-Q3 2020 compared to 15,300 at US$2.5tn in the same period in 2019. These are declines of 28% in volume and 29% in value, with quarterly totals through 2020 so far among the lowest in the past five years.

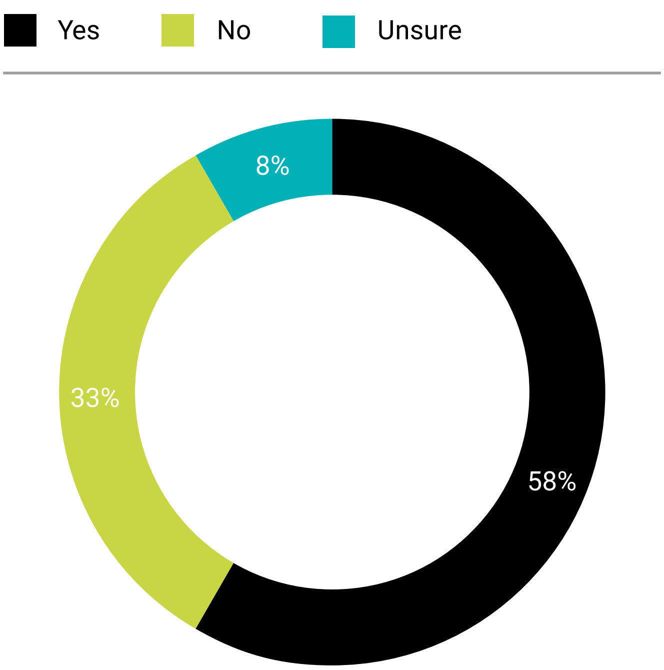
While Asia-Pacific, where the impact of the virus was first felt, has maintained some of its resilience, COVID-19's impact on markets in North America and Europe has caused global M&A to faulter. Particularly in the US, lockdowns and social distancing measures have had a significant impact on economic productivity. Additionally, the US faces high levels of political uncertainty from the looming presidential election and widespread, large-scale demonstrations and protests in recent months.

Given the level of uncertainty and volatility globally, cross-border dealmaking has been put on hold to some extent. Contrasting Q1-Q3 2019 with the same period in 2020, international deals fell 31% (4,019 vs. 5,854) and 36% by value (U$715bn compared to US$1.1tn). Domestic deals, while also dropping since 2019, posted lower declines of 26% by deals and 25% by value as dealmakers keep M&A close to home.

This is reflective of the 57% of respondents considering limited domestic M&A and 17% that say the pandemic is having no impact on their intentions to make investments within their home borders.

Tech-driven M&A has become a feature of the current market as dealmakers seek out tech and digital assets to transform their businesses. While part of an ongoing trend in recent years, this was solidified by the pandemic amid the necessity for businesses to become virtual as consumers were driven online. In Q1-Q3 2020, TMT was the top performing sector for M&A, accounting for 22% of deals and 28% of value. This was followed by the industrial and chemicals sector in volume (15% of deals) and energy, mining and utilities by value (16%).

Figure 5. Generally, will Asia-Pacific see a quicker economic recovery post-COVID-19 than other global markets?



Deal challenges in the year ahead

Consolidation and investing in emerging markets will be the main strategies driving M&A in Asia-Pacific, although respondents recognize several challenges that could stall or derail dealmaking.

Dealmakers agree that industry consolidation and seeking growth in emerging markets will be the main drivers of M&A in Asia-Pacific, according to 92% of respondents for each strategy respectively. Another 38% say consolidation will be their top driver, alongside 30% who are targeting emerging markets, as they adjust to the complexities and impact of the ongoing pandemic and prepare for a post-COVID-19 world.

"Industry consolidation will certainly increase the potential and sustainability of companies. For combining efforts in marketing, vendor management and warehousing, consolidation is one of the better options," says one dealmaker.

Another dealmaker says there may be more and better opportunities in Asia-Pacific for industry consolidation since such combinations have not been as widespread compared to other global markets. This is especially true of the region's mid-market space, where one respondent says, "Smaller and mid-market companies can pool their resources to make a considerable impact on the market within a shorter period of time."

Emerging market opportunities and the search for growth also garnered favorable sentiment toward doing deals. Summarizing the opinions of several respondents, one dealmaker speaks to Asia-Pacific's advantage saying, "When developed markets do not allow for implementation of growth strategies, due to political or economic constraints, emerging markets are sought. Corporate buyers and private equity investors will try and seize the opportunities sooner. There are favorable valuations as well, which would also contribute more to the decision."

Valuations (52%) are another key deal driver and one cited by many respondents as a key regional advantage.

"The amount of global stimulus and strong investor sentiment indicates that industry leaders are actively looking to strike on the right deals. This might actually be an incredible period for corporates with strong balance sheets and cash reserves to focus on strengthening their core by getting deals at reasonable or even bargain valuations."

Gaurav Drolia, Partner, Baker Tilly India

Figure 6. Which of the following deal drivers will contribute to M&A strategies in Asia-Pacific in the year ahead?

Key geographies

Strong sentiment for Asia-Pacific's emerging markets is reflected in both the destinations where dealmakers have completed investments and the markets where they see future opportunities. Emerging Southeast Asia (excluding Singapore) stands out for its growth prospects, with 57% of dealmakers having completed deals there within the past two years. Another 90% saying the sub-region offers significant M&A opportunities.

"Southeast Asia has good potential. Once the COVID-19 situation is resolved and businesses get back on track, there will be faster development in these regions. Reforms should be initiated by the governments to accelerate growth and support smaller businesses," says one respondent.

India also ranked high with 63% saying the country offers good deal opportunities. Respondents note growth prospects as driving these sentiments, with one mentioning that India has served as a "gateway towards expansion in the region."

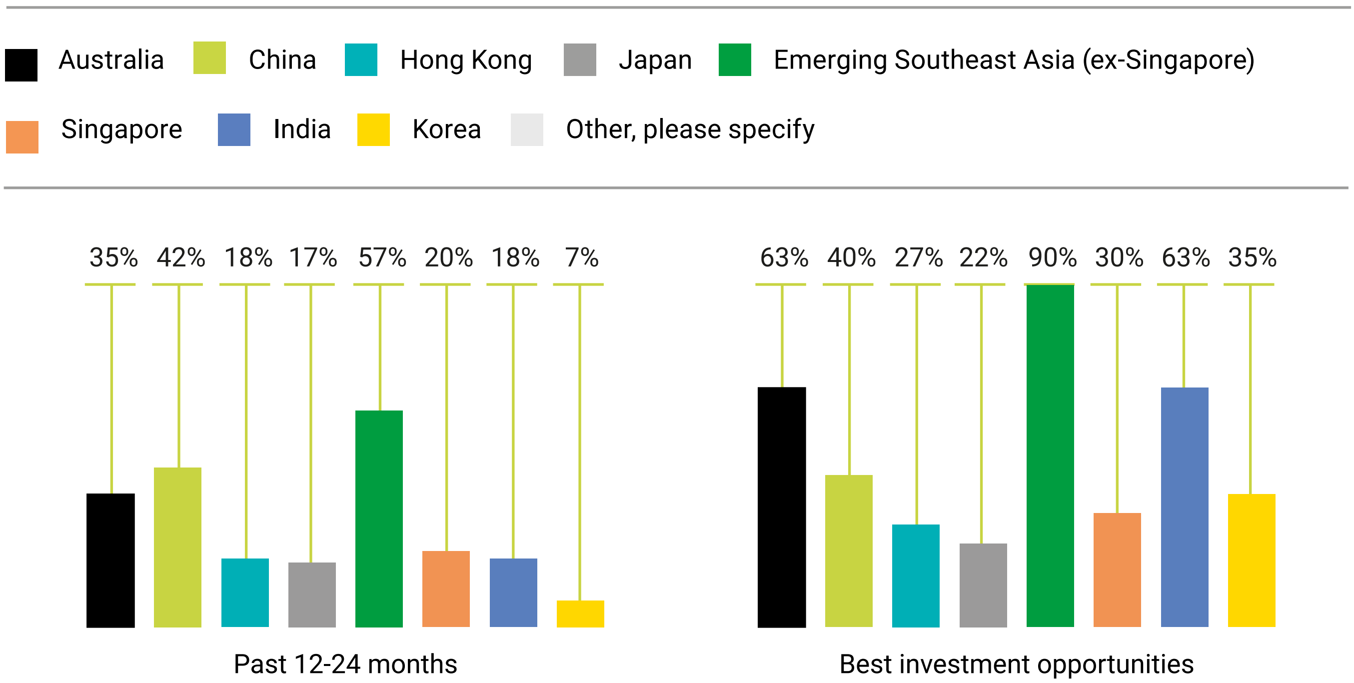
Investments into advanced markets are also abundant in Asia-Pacific. Indeed, 63% of dealmakers say that Australia is very much on their radar screens. Many dealmakers cite Australia's market stability and strong fundamentals as major positives and one says that "Australia has been sustainable through the crisis. Steps to prevent the spread were taken during the earlier stages itself, which proved effective." Another says, "For new market entrants and for implementing traditional investment strategies, Australia shows good potential."

Australia's strong and diverse mid-market is also a key feature. These companies provide "good valuations and fewer hurdles," says one respondent. Another adds to this by noting how interest in small and mid-cap Australian businesses is being driven by plans to use the country as a launch pad to further investments throughout the region.

Challenges

Regardless of the region's advantages, the rest of 2020 and the year ahead will prove challenging. While respondents mention numerous obstacles, commentary focuses on a handful of issues that will prove particularly burdensome.

Figure 7. Generally, will Asia-Pacific see a quicker economic recovery post-COVID-19 than other global markets?



COVID-19 health crisis

While disruption to business continuity has led to depressed productivity levels at some companies, the real challenge for investors has been the widespread travel restrictions and lockdowns that have made it difficult to conduct due diligence. As such, dealmakers have had to find new ways to complete due diligence, conduct management interviews and exchange legal documents remotely.

"As due diligence has become tough on buyers, identifying optimum targets will also become challenging," says one respondent, who goes on to say that rising cybersecurity risks, IP challenges and potential legal issues make it all the more important to not cut corners when completing due diligence.

The pandemic is likewise creating economic uncertainty in key markets that is making it difficult to accurately forecast growth and business prospects. According to one respondent, "Mainly, the challenge will be dealing with the impact of the health crisis. It is important for most countries to avoid another wave, so business-as-usual cannot be expected. Due diligence will be tougher and investor interest will decline somewhat."

Geopolitics and the US-China trade war

Geopolitical concerns and the ongoing US-China trade war are influencing M&A strategies and posing a challenge to dealmaking. According to one respondent, "The uncertain economic and political conditions are the biggest challenges we expect to face in 2020. For completing due diligence and overall negotiations successfully, ideal circumstances such as local government support and familiarity with economic trends will be missing."

Equally, more than half of respondents (58%) say future deals in Asia-Pacific will be completed in response to regulatory or tariff changes and geopolitical events around the US-China trade war, while 50% say they would be doing deals to avoid entanglement in the trade dispute itself. Another 43% said securing supply chains would be the priority.

According to one respondent, "the tariff changes and geopolitical factors influencing decisions in North American and European markets will push investors towards Asia-Pacific." Another says, "The US-China trade war will be closely watched, as the potential policy changes could affect outbound and inbound trade, not only with China, but also with surrounding countries."

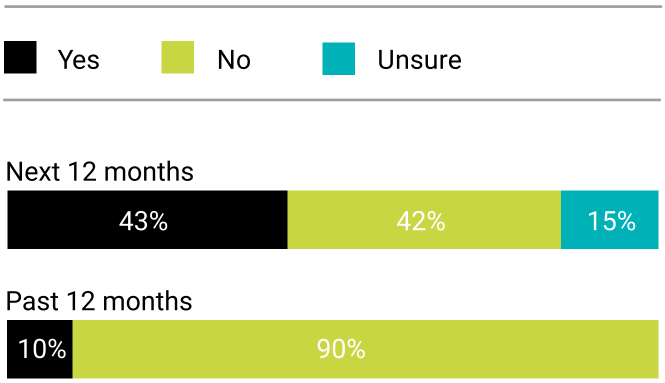
National security

In the vein of geopolitical concerns, national security issues will also be a rising issue. Large numbers of dealmakers (43%) expect these matters to impact or interrupt their deals in the year ahead, compared to only a handful who experienced political interference during M&A in the past. Another 15% say they are unsure of what to expect when completing deals through 2020 and in 2021.

"Pipeline deals are more likely to be reconsidered because the dealmaking situation has changed. The national security laws and threats will prevail and even smaller transactions will be affected," says one respondent. Another says, "This will be an issue for dealmakers, because of the potential disruption to supply chain and transfer of information. Since this is the age of globalization, transparency is the key to prompting growth and initiating inorganic growth objectives."

However, others are hopeful, mentioning that while there may be some interference in the deal process, overall, M&A will continue one way or another. "I think there will not be any issues for dealmakers, if they are prepared. Including political risks into due diligence calculations would be important to arrive at practical and objective decisions, though," says one respondent.

Figure 8. Have matters of national security impacted or interrupted potential deals for you within the past 12 months? Do you feel this will be an issue for dealmakers in Asia-Pacific in the next 12 months?



Spotlight: **Private equity**

Dealmakers think private equity will be a driving force in the M&A market across Asia-Pacific; however, recent developments in Hong Kong could complicate matters for funds using the city-state as their base.

Private equity buyout activity in Asia-Pacific has also posted decreases through this year. In the first three quarters of 2020, buyout activity shrank 13% in deal volume (350 buyouts) from 2019 (404 deals), although value posted a slight uptick of 2% with totals of US$72.5bn. For the quarter, buyouts declined 26% in volume and 10% in value from Q3 2019. This is despite the record US$388bn worth of dry powder private equity firms are sitting on, according to data from Bain & Co, with most funds still focusing on improvements to existing portfolio assets rather than new investment activity as they hold on to see how government responses to the pandemic play out.

Dealmakers, however, are hopeful that a turnaround in private equity investment activity will unfold in the short term. Reflective of sentiment that Asia-Pacific offers better PE buyout opportunities (according to 53% of dealmakers) than other regions, 55% say there will be an increase in buyout activity in the year ahead. According to one respondent, "I think the activity will increase because there are more buyout opportunities. Distressed sales have increased, as regional companies are not able to cope with the financial impact after COVID-19 lockdowns."

In that vein, distressed M&A and divestitures could fuel dealmaking among funds, with one respondent noting that "dealmaking appetite of private equity firms will increase as corporations are offering carve-out deals and minority stakes to raise capital for core operations. The economic landscape will change in a couple of years and private equity firms can look forward to accelerated returns."

Asia-Pacific's promising economic growth and recovery also play to dealmakers' favor. "The Asia-Pacific market has delivered positive results for private equity firms. There are better exit opportunities, because global companies seek Asia-Pacific markets for stronger returns," says one respondent.

Figure 9. Asia-Pacific buyout trends

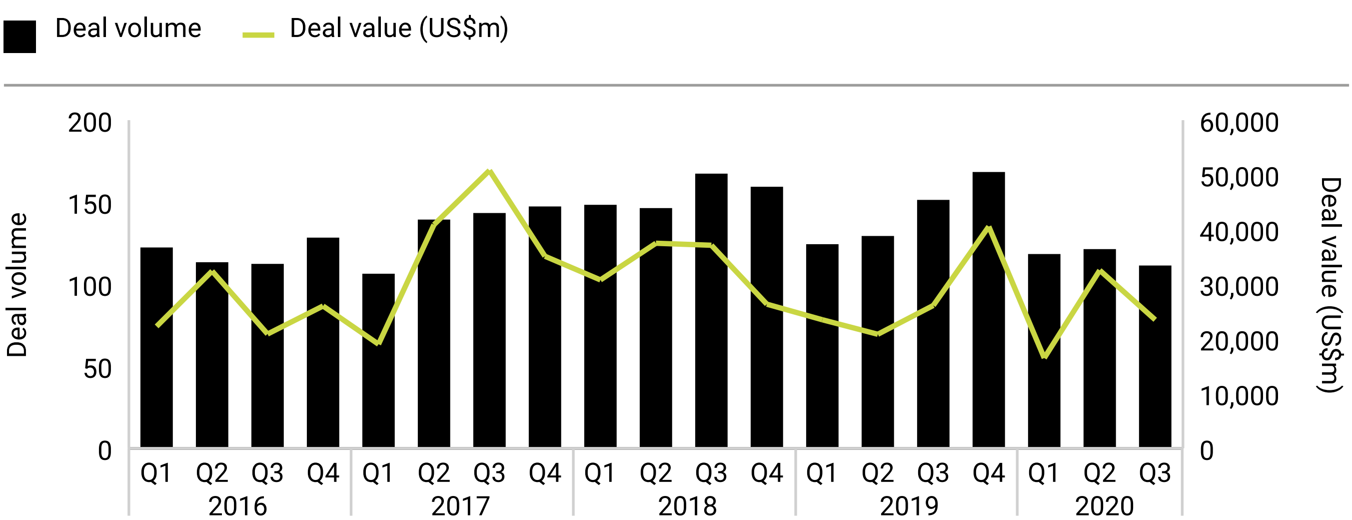


Figure 10. What do you expect to happen to the level of private equity activity in Asia-Pacific in the year ahead?

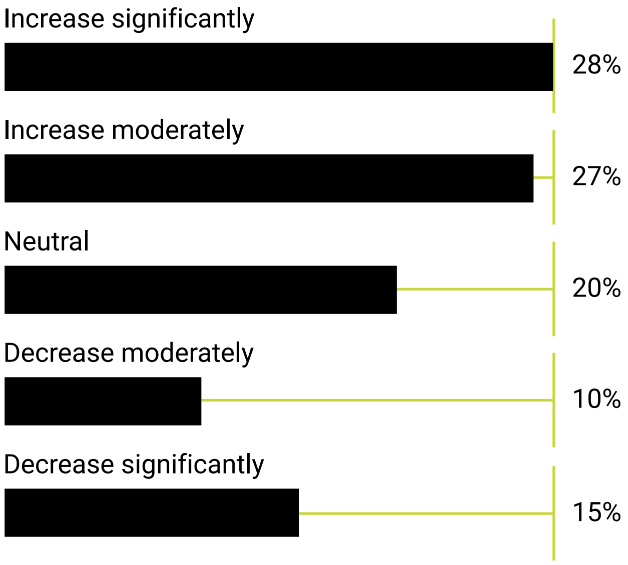
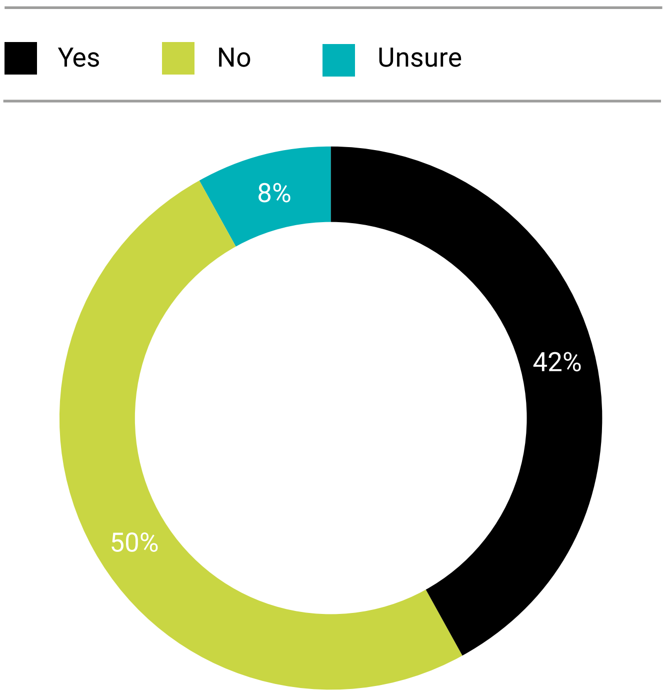


Figure 11. Do you feel that PE funds based in Hong Kong will begin relocating elsewhere in Asia-Pacific given recent changes to the city-state's security laws?



Changing tides: Hong Kong and the new national security law

The passage of a new security law in Hong Kong has raised questions about the future of the autonomous region as a hub for investment within Asia-Pacific. While the impact of this new legislation has yet to be fully felt, dealmakers seem split on how it will mold investment trends in the future.

Almost half of dealmakers (42%) say private equity funds based in Hong Kong may start relocating as a result of these recent changes. One respondent says, "I expect funds to react to the city-state's security laws and relocate as soon as they find a better location. There are other markets in the Asia-Pacific region with lesser political and social risks." Another says that "will present additional challenges. The Trump administration enforcing new policies for discouraging Chinese influences could potentially harm funds if they do not relocate."

"Private equity funds have a high level of dry powder in the region and are actively assessing new opportunities. However, pricing gaps between buyers and sellers are leading to longer discussions and funds are cautiously waiting and not rushing to deploy funds yet. The crisis is forcing companies to transform and adapt at speed. This is where PE firms play an important role in the recovery as they have capital, skills, and experience to help create value and work through these challenging times."

Adrian Cheow, Partner, Baker Tilly Singapore

Yet most dealmakers (50%) say that a flight of capital and fund relocation is unlikely. Relocation takes time and incurs significant costs, which may prove prohibitive for smaller funds. Funds already based in Hong Kong have made this decision based on its advantages and the perceived disadvantages and risks of setting up shop elsewhere and one respondent says that "PE funds based in Hong Kong have established their business in the region and conduct global activities, so relocating to other regions could contain more risks."

Still another says that "Hong Kong is a financial hub and one of the most important in the Asia-Pacific for considering gateways to other markets. Relocating elsewhere is not the right option, as this could have a negative impact on dealmaking activity and pipeline projects." Many respondents say that such decisions should not be made in haste, "in case the city-state's security laws do not threaten to affect the continuity of businesses in the region. There are different views about how the laws will affect target valuations and taxation, but private equity funds will not relocate."

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Mergermarket is an unparalleled, independent mergers & acquisitions (M&A) proprietary intelligence tool. Unlike any other service of its kind, Mergermarket provides a complete overview of the M&A market by offering both a forward-looking intelligence database and a historical deals database, achieving real revenues for Mergermarket clients.

To find out more, please visit www.acuris.com

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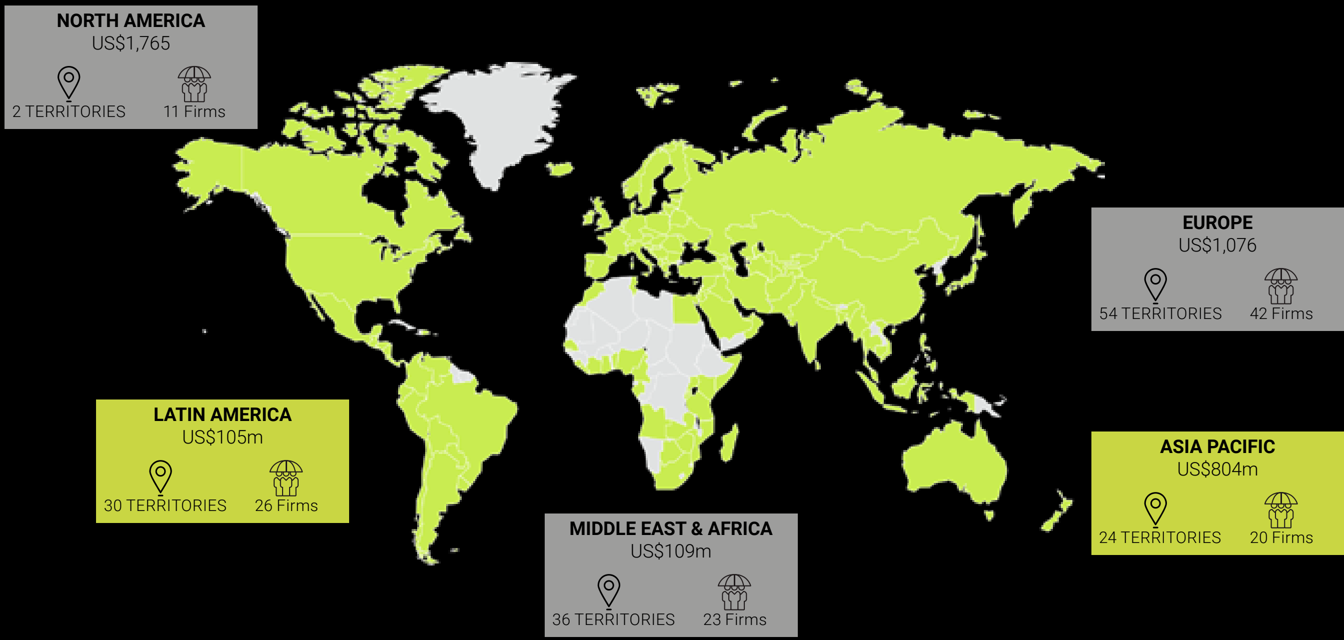

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US$3.9bn
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