CLIFFORD CHANCE

GLOBAL SHIFT: M&A PREDICTIONS FOR 2023

– THOUGHT LEADERSHIP

JANUARY 2023

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We are currently witnessing a slowdown from the deal-making heights of 2021 and early 2022, as geopolitical instability, inflationary pressure and interest rate rises have dampened M&A activity. While these issues will persist for some time, cooling the market overall, we are confident there will be busy pockets of deal-making activity in 2023.

Sarah Jones, Global Head of Corporate, says: "The cost of, and access to, capital will shape global M&A on multiple fronts in 2023. As debt matures, large corporates will seek to delever balance sheets, driving carve-outs and non-core asset sales. The strong dollar should support US-based corporates as key buyers. Meanwhile, faced with more expensive debt markets, we expect financial investors to look for ever-more complex, creative opportunities, and green investments."

And Riaz Pirmohamed, Senior Associate in Clifford Chance's London Corporate Transactions and Advisory practice, adds: "Deal-making activity will be driven in part by growth strategies shaped by government policy and regulation, particularly around climate and infrastructure, as governments look to stimulate economic recovery. However, the current systemic risks are also causing countries and economic blocs to insulate themselves through protectionist regulatory action, presenting challenges for efficient deal execution.

Digital infrastructure and the energy transition are sectors to watch. We expect them to generate significant cross-border M&A as investors target both attractive returns and social impact. Meanwhile tech is heading for a calmer period, with a steady, more sober approach to deal-making and a focus on more rigorous diligence in light of recent high-profile governance failures. We also anticipate activity in other sectors, where companies have strong balance sheets with the capacity for large M&A, as well as a strategic imperative to do so, such as healthcare companies facing a looming expiry of patents over key drugs."

1

ENERGY TRANSITION INFRASTRUCTURE: BOOM TIME FOR 'MARKET FIRST' ASSETS

Infrastructure will continue to be seen as an attractive and safe asset class, particularly in the energy sector. Expect to see a rise in innovative investments that support energy transition targets, for example, renewable energy islands in Europe and those clean hydrogen cluster projects that secure bankable offtakes.

Patrice Viaene, Counsel in Clifford Chance's M&A Infrastructure team in Brussels and member of our Clean Hydrogen Taskforce, says: "Emerging technologies, such as clean hydrogen and the capture and storage of CO_2, will be in demand. To reach Net Zero we need to rapidly accelerate investment in 'plumbing infrastructure', such as interconnectors, storage facilities and the renewable energy islands needed to transport renewable energy and hydrogen between regional economies. Likewise, we also expect significant capital investment in energy grids, to address intermittency issues from increased renewable energy generation.

Investment will be driven by a desire to capitalise on emerging technologies that could have global application as we strive to become carbon neutral."

Rizwan Butt, Senior Associate in Clifford Chance's M&A practice in Dubai, adds: "Whilst capital flows will accelerate toward renewables and energy transition assets, fossil-fuel based energy will have continued relevance, driven in Europe by a need to substitute gas previously supplied by Russia, in other developed nations where fossil-fuel based energy is a strategic source of revenue, and in many developing nations where energy transition is a more gradual process due to the roll-out of electrification being the main priority."

TECH: COOLER HEADS

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After a tough year for tech, we expect a shift in the dynamics of tech M&A: greater investor caution, backed by greater bargaining power with softer valuations and investors holding their dry powder – cooler heads for a cooler market.

Brian Harley, Technology Consultant in Clifford Chance's M&A practice in Hong Kong, explains: "Challenging macroeconomic conditions won't kill tech. Growth investment may have become relatively less attractive for a time, but innovation will continue: keep ahead of your peers or become irrelevant. The end of cheap money will mean less froth in tech, but the long-game tech players will continue to build to stay ahead of the competition.

Expect fewer new unicorns and more strategic consolidation through bolt-on acquisitions and business co-operations. Growing companies will still raise funds, even if some will have to be willing to test their down-round mechanics. Even in crypto, which has had an especially bad year, we hope to see companies that have pursued more sober applications of blockchain technology continue to grow."

And Ona Odili, Associate in the Clifford Chance Tech//Digital practice in London, adds: "In 2023 investors will be less willing to bow to the star power of founders and skimp on due diligence. After recent high-profile failures, no tech investor will want to be asked: 'How did you not spot this?'. This means moving away from the light-touch approach to diligence that has been common for tech targets and towards more focused checks of the specific drivers of the target's future growth and how it manages its critical business risks."

PROTECTIONISM: HEIGHTENED DEAL RISK AND PROLONGED TIMEFRAMES

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Policy-making across the globe, aimed at controlling foreign investment and protecting home-grown industry, will impact M&A in the year ahead. Together with enhanced scrutiny from regulators, this will increase execution risk, extend deal timelines and may lead to new deal structures.

Milena Robotham, Counsel in the Global Antitrust practice in Brussels, explains: "Regulators are finding more ways to scrutinise inbound investment. New foreign direct investment controls and subsidies regimes were introduced last year, for example in the UK, and other countries have regimes in the pipeline including Belgium, The Netherlands and Luxembourg. Whilst originally conceived to target specific activities or advance a certain regional political agenda, the final drafting can be sweeping in nature, bringing into scope a much broader set of corporate activities than one might imagine and catching what would otherwise be seen as 'no-issue' deals – such as those outside sensitive sectors, involving no overlap in sales or market activity. The new EU Foreign Subsidies regime, which will take effect in mid-2023, is a good example of this."

Holly Bauer, Associate in the CFIUS team in Washington D.C., adds: "There will be more scrutiny and intervention within existing FDI screening regimes. The US CFIUS regime is set to heighten scrutiny in sectors such as semi-conductors and AI, in addition to an increased focus on tech and personal data more generally. We also expect to see new frameworks implemented this year, for example the US has taken steps to introduce so-called 'reverse CFIUS' rules to make way for review of certain outbound US investments."

Zibo Liu, Counsel in the Global Antitrust practice in Beijing, adds: "The current trend of merger control authorities adjusting their thresholds to catch a wider set of deals will continue. In addition, we will see countries with relatively new merger control regimes seeking to take a conservative position, so as not to lose jurisdiction over high-profile deals. Dealmakers will have to build in timeline flexibility, consider novel approaches to conditions precedent and potentially explore innovative deal structuring to mitigate this increased merger control risk."

4

CARVE-OUTS: FRESH VALUE; INCREASED COMPLEXITY

Carve-outs will drive significant M&A activity in 2023. Whilst some will arise by necessity we will also see the best-advised players seeking to unlock fresh, and perhaps previously unforeseen, value through well-designed carve-outs, with new levels of complexity.

Mark Comber, Senior Associate in the Tech//Digital practice in London, explains: "Carve-outs are inevitable in difficult economic times, as companies look to shore up balance sheets and administrators break up businesses. As merger control and FDI scrutiny surges, buyers will also find themselves needing to sell parts of their own business, or the target business, to complete acquisitions.

On top of this, in 2023 savvy corporates will increasingly pursue carve-outs as an integral part of their boardroom strategy. This could be to improve green credentials by spinning out carbon-heavy assets, or to monetise a non-core element of the business which has soared in value, such as a data set. Others may explore partial divestments to release value in underlying assets such as infrastructure, resulting in both an up-front cash injection at completion and, with the right long-term agreements in place, sustained and fixed revenue streams. Expect to see distribution, manufacturing and master services arrangements, as well as IP licences, becoming commonplace on carve-out deals.

More creative deal mechanics are rising in prominence as well, like using intricate licensing arrangements to satisfy antitrust authorities and avoid divesting assets."

And Matthew Warner, Counsel in Clifford Chance's M&A practice in New York, adds:

"From a buyer's perspective, carve-outs have long represented an opportunity for financial investors to extract key profit centres or mid-performing assets from larger groups and develop more profitable stand-alone businesses. The current market dynamics present a clear 'win-win' opportunity, potentially with innovative structures around long-term commercial arrangements or strategic partnerships to support valuation and the lack of cheap debt financing. For sellers, a well-executed carve-out can be a major success story in and of itself – but careful preparation is vital. Alongside splitting shared assets and services, a judicious seller may, for example, seek to accelerate the deal timeframe by segregating a regulated part of the business, or otherwise stagger the sale in order to improve tax efficiency."

ESG-LINKED DRY POWDER: SHAPING THE FOCUS AND FLAVOUR OF M&A

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With over $70bn of dry powder targeting impact investments amassed to date, we expect to see ESG funds seek to invest this capital in aligned opportunities in 2023. Together with an increasing pressure for generalist funds to favour green opportunities, this will drive M&A by financial sponsors in businesses with strong ESG credentials.

Stephanie Dunne, Senior Associate in the Private Funds practice in London, explains: "PE funds with an explicit ESG angle to their investment strategies and criteria have in recent times tended to have more robust fundraising rounds than generalist funds, attracting more investor interest. As these funds move into their active investment period, we expect M&A in businesses that meet those ESG criteria to show strong growth this year.

The focus on ESG from investors will remain, continuing a trend of generalist funds seeking to align with enhanced ESG criteria. New ESG regulations, such as the Sustainable Finance Disclosure Regulation, which is often used by investors to guide allocations, will also lead to generalist funds developing their strategies to improve their asset management and reporting – and ultimately their investments – from an ESG perspective.

We also expect to see further innovation by managers as to how to embed ESG within their business, with impact linked equity – carried interest that is partly tied to the ESG performance of a fund – potentially one of the tools in their arsenal."

Moritz Petersen, Counsel in the Clifford Chance M&A practice in Frankfurt, adds: "The focus on ESG within the private capital markets will be mirrored in the public markets, both in relation to listed asset managers but also through institutional investor pressure and regulation more generally. As the approach continues to move away from avoiding negative consequences towards promoting positive change, businesses with strong ESG credentials or that help support the ESG strategy of a buyer are likely to be seen as more attractive targets. Oil majors looking to broaden their asset base with renewables/clean energy targets would be a clear example, and it will be interesting to see if these businesses are able to command higher valuation multiples."

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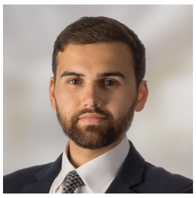

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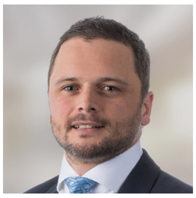

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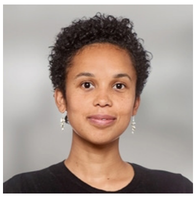

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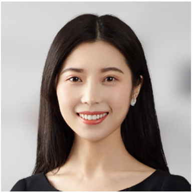

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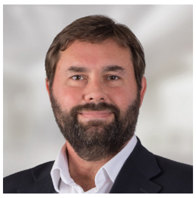

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