## Exchanges at Goldman Sachs

M&A Outlook: How Companies Are Positioning For Growth
Mark Sorrell, co-head of Global Mergers & Acquisitions, Investment Banking
Stephan Feldgoise, co-head of Global Mergers & Acquisitions, Investment Banking
Allison Nathan. Host

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Allison Nathan: This is Exchanges at Goldman Sachs. And I'm Allison Nathan, a Senior Strategist in Goldman Sachs Research. Today we're going to discuss the surge in M&A activity and what's in store for the second half of this year. We're joined by Stephan Feldgoise and Mark Sorrell, the global co-heads of Mergers and Acquisitions in the Investment Banking Division here at Goldman Sachs. Stephan and Mark, welcome back to the program.

Stephan Feldgoise: Thank you for having us.

Mark Sorrell: Look forward to it.

**Allison Nathan**: You were both on this program back in February discussing the rebound in global M&A and the appetite for companies and private equity sponsors to engage in, at the time I think you described, and I think it was you, Mark, who described it as "big, bold, strategic moves." Has that level of activity continued? Mark, maybe you can answer that.

Mark Sorrell: Sure, thanks Allison. I would say very broadly speaking, since we last spoke, we've really seen activity really continue, at least at the pace that we saw it in the first part of the year. I think that as the year has gone on, I think appetite, as we talked about last time, appetite for clients to consider larger transactions, so both on the corporate side and private equity side, I think has built. So, I think we have seen a continued improvement in confidence and a continued desire to pursue, you know, larger and bolder moves across pretty much every sector, every size, every region. And we've seen it continue to build through the year I don't know, Stephan, what would you add to that?

**Stephan Feldgoise**: Yeah, it's interesting. You know, when we met back in February, I think we had a debate, we certainly had a debate amongst ourselves, as to whether this was pent up demand coming out of, obviously, the pandemic that we all, hopefully, are coming out of around the world, but certainly at different paces.

But what we really found is that it might have started with the pandemic, coming out of the pandemic. But it really was strategic repositioning. It was shareholders remaining emboldened to support their boards and management teams to reposition the companies to grow. Organic growth is hard. And so, M&A remains a very attractive method to grow the businesses. And you saw not just horizontal mergers, vertical integration, new product lines, obviously SPACs, LBOs. We saw one of the largest LBOs of all time. And that's not just pent-up demand. That's the desire to look forward and the desire to continue to drive businesses, which is why we've seen the trend in volumes continue at, you know, all time highs.

**Allison Nathan**: So, what's really underlying that sustained momentum? Is there optimism about growth and companies wanting to take advantage of that. Or is it more defensive in nature?

**Stephan Feldgoise**: Much like activity is in every region, in every sector, I'd say it's all of the above. There are some companies, and it varies by industry and geography. Some that are

saying, defensively, I've spent the last ten years taking costs out of my supply chain. Supply chain is now strategic, particularly in points in times of stress where I need to have a diversified supply chain. It might cost me a bit more to have a broader supply chain, but it has to happen because I can't be faced with whatever geopolitical or pandemic reasons being shut off from my supply chain. So, that's defensive.

On the offensive side, there are a limited number of companies and businesses around the world. And particularly when your peers or competitors are moving, you feel the need to move and scale. If anything has been proven coming through both the financial crisis and then we saw in the pandemic scale matters. Having the balance sheet, having the financial capability, having the geographic diversification and product diversification matters because you just don't know what could be impacted. Who would have thought that one of the most robust sectors would have been the center store and grocery stores last year? You know? Food retail had been challenged for very many years. And it came out as, you know, the stalwart through the pandemic as people were, obviously, all eating at home and taking delivery from grocery stores. But you know, predicting those things is very difficult. No matter how smart we are, the strategic consultants are, the boards are, which they are smart, there's going to be black swan risks. And how do you plan a business and structure a business that isn't on the hair's edge, as I mentioned, around supply chain where small disruptions can cause massive issues for your business? And so, that's a big repositioning.

Then on the growth side, as I said, organic growth is hard. New product lines, which might have been a bridge too far for an M&A deal previously, now are in focus. They say, that's how we're going to grow our business. And our shareholders and boards are supporting it.

**Mark Sorrell**: I was just going to add to what Stephan said, which I agree with. I think that if I were going to pick out two things in addition to what Stephan mentioned, I think I would emphasize the importance of a growth focus or a growth mindset amongst our client base.

I think that clients believe we are entering, and we are in a period of sustained, you know, above trend, global growth. And want to take advantage of that and be positioned for it. And as Stephan, I completely agree, I think many clients have taken cost out. Repaired balance sheet. Done a lot of self help, focused on organic growth. And M&A is now a really important part of the toolkit to position the business for growth.

I think the other thing I would say is that I think technology is a theme in so much M&A today. Now, it may not be the primary driver or secondary, but it is quite often on the list. And if you just go through many of the sectors we deal with, so much M&A outside pure sort of technology businesses has a tech aspect to it or a tech theme underpinning it as well. So, I think you have a very powerful mix of growth focus, focus on supply chain as Stephan has said, focus on technology, focus on ESG. All of these things are really strong tailwinds or impetuses towards using M&A as a way of improving businesses.

**Allison Nathan**: So, what is the outlook for M&A in the second half of the year? Stephan, maybe you can start.

**Stephan Feldgoise**: Yeah. So, start the pools to capital. There has never been more capital sitting in private equity, in sovereign funds, in SPACs looking to do transactions. Obviously, everyone spends a lot of time thinking and talking about the regulatory landscape amongst our corporate clients, as you would expect. But capital needs to be put to work. And so, you see it abundantly put to work there.

I would also say the dialogue and the level of dialogue in the boardroom remains as it has all year at an all-time high. Some people have gotten things done. A lot of people are still looking to get things done. And deals take time. And different industries have emerged from the pandemic at different phases, as have different geographies. So, as different geographies are starting to see, much like we saw in the first half of the US, the economies accelerate coming out of the pandemic. And the US economy continued to operate at a very high level. The desire to get things done remains very high.

And so, our outlook, you know, barring some major change in the fundamentally drivers, cost to capital, amount of capital, boards and shareholders, most importantly. You know, we talk about boards of the companies, but the shareholders are the eventual judges of deals. And they are very supportive of the very active M&A. And they've continued to look to the second half. I was on with a bunch of investors yesterday, and they all were talking about pushing their boards and management teams to find the right strategic transaction and to move on it to make it happen. And that they will support it.

And so, our outlook remains very strong. Our team remains incredibly busy around the world in all polls. And we feel very good about the team that we have. Obviously, it's a group of dozens and dozens of partners and teams around the world. And the dialogue that we are hearing from all of them remains incredibly robust.

**Mark Sorrell**: Maybe just to add to what Stephan said, I think the one part of our global business which has been inevitably quieter in the last few months during the pandemic has been true cross border M&A. So, transatlantic, you know, Europe to Asia, US to Asia. Now, there are good reasons for some of that. But a key reason has been inability to travel.

And I think that as we see travel being easier, particularly in all of those cross-continent flows, I think we feel that big cross border M&A will come back quite quickly. And we feel there is a lot of pent-up focus on that. And we're beginning anecdotally to see the first signs of that picking up. So, I think that's definitely something to watch as we exit the pandemic and it's easier to do these transactions. I think it's the one part of what we do that has been really hard to execute during the pandemic for most clients.

**Allison Nathan**: The other thing that we've actually seen in this recent period has been a surge in private equity backed M&A acquisitions and leveraged buyouts. So, what's driving the sponsor interest now? And do you expect that to continue?

**Stephan Feldgoise**: You know, it's interesting, if you look back over the last several decades, there was always a strong debate as to which asset class would have the strongest returns through different cycles. And over the decades and at various times it was hedge funds, they're very, very liquid. They could get in and out of positions. At various times it was private equity. At various times it was corporate equity.

But what's really been interesting is the consistency and significance of the private equity returns. And so, they've garnered tremendous capital. If you look at the size of the funds that are being raised, both by classic private equity, but importantly, you're seeing a lot of what I'll call sovereigns and family offices of scale getting involved with transactions and having a tremendous amount of cash liquidity. We've all read about and know about the amount of cash that has been accumulated during the pandemic. It's only been exponential inside of private equity. So, as the returns have been very good, they've garnered greater capital. And for them

to money and returns, they need to invest. And it's the only way to make money, obviously, if they have asset management fees. But that's on the capital that they invest. And so, that driver, the introduction of new private equity capital into the traditional private equity universe, makes them incredibly aggressive.

And I'd say, you know, the returns profile that they may have looked for ten or 15 years ago, I'd say, has tightened to a degree so that it has only presented more opportunities and made them more competitive in terms of competing for businesses.

**Mark Sorrell**: I would say that I think you have a fund-raising dynamic, which Stephan put very well, in terms of, you know, the growth of assets under management, the size of funds, the globalization of funds. And then I think there's another interesting trend that I would add, which may be temporary, or it may be more permanent, which is kind of the shortening of investment cycles. So, the churn of assets or the turnover of assets within the private equity industry. And I think investment cycles, what we see there, shortening, i.e., the gap between entry and exit on average, I think, there's evidence to say that that's shortening. And so, therefore obviously, that feeds transaction flow.

So, I think that there is a velocity of transactions in the private equity industry that is quite remarkable, and I think, quite sustainable as well.

I think one other interesting trend to add, which is a particularly, I think, European trend, has been the real pick up in the private equity industry being active in public to private transactions, i.e., taking public companies private. And we've really seen that in a number of European markets, particularly the UK, the Nordics, but pretty much everywhere in pretty much every sector. We've worked on many of these transactions in the first half of the year. And I think that is a trend that I expect will continue and continue to be very strong in Europe in particular and will probably extend itself to Asia as well over time.

Allison Nathan: Another big area of focus that you briefly mentioned, of course, is SPACs. We saw a big increase in attention last year. It continued into earlier this year. We've talked about SPACs a lot, even on this program. Obviously, the headlines have shifted a bit. The focus right now really seems to be in the prospect of increased regulatory scrutiny. So, how much are SPACs contributing to overall M&A volume today? And do you expect that to continue? For it to remain robust, even despite the scrutiny? Stephan, maybe you could start.

**Stephan Feldgoise**: I'd say today, SPACs are a modest part of the market. But they're still happening. There are still a hundred plus SPACs who have raised capital that have a time backend that are aggressively looking for transactions. And SPACs have filled a part of the market. There was a willingness to put capital to work. There was a willingness for companies to take that path to go public. There was a willingness of very seasoned, high-quality executives who raised SPACs to also add assets, i.e., intellectual capital to a combination with a private company and take it public via a SPAC. So, there was market need.

Parts of that have, obviously, waned to a degree in terms of just the market appetite for both the pipes as well as putting capital into new raises for SPACs. That being said, we expect that SPAC M&A component to continue, certainly through the year and into the next year at, probably, more current velocities than the velocities we saw at peak, which were obviously extraordinary back in the beginning of the first half of the year. But it's going to remain a part of the market. I think it's important. And it fills a component of the IPO process that there was a market demand.

**Mark Sorrell**: And I would just add to what Stephan said, I think that we've seen this more in the second quarter since our last discussion in Europe where we've actually started to see the first European assets bought by SPACs and the PIPEs done. I think what we see is for good quality assets where public marketer investors would like access to those assets, those SPACs have done well, and those transactions have done well. So, I think just to echo what Stephan said, I think for good assets in the right space, I think there is support for these structures and we'll, on a more selective basis, but there is still good support for interesting businesses in the right sectors. And I think we will continue to see the build up of the European SPAC space.

**Allison Nathan**: As the interest in SPAC has come down just a bit, or the activity, I should say, in SPACs has come down just a bit, what's filled the gap? Where are M&A transactions really centered right now?

**Mark Sorrell**: I think directionally, the private equity industry, as we've been talking about has, if anything I would say, been more active in the second quarter than in the first one. I think corporate activity also has continued to build, with a focus on larger transactions as well.

So, I think that broadly speaking, what you've seen as the year has gone on is willingness to take greater risks, I think, principally around size of transaction. And so that, if you like, filled the gap in my view.

**Stephan Feldgoise**: The vast majority of transactions that we spend our time on are between 500 and 10 billion dollars. There has obviously been some good activity in the mega transactions, but I really expect that 500 to, you know, 5 billion, 500 - 10-billion-dollar category to remain very active. That's been the engine room of M&A throughout this boom. I expect that to continue. That's also prime striking ground for private equity. And it's prime striking ground for SPACs. It's prime striking ground for large corporates that want to add a business or add a line that's not transformational. So, not to do something that is so fundamental that's, quote/unquote "a merger of equals." But really is an addition or strengthening of their existing business. And that's the boom that we're seeing. And that's what we can expect to continue throughout the fall.

**Allison Nathan:** When you think about other trends in activity, we've obviously seen environmental and social themes becoming a greater factor in shareholder activism. Are there any key takeaways from some of the activism we've seen this year? Stephan, maybe you can answer that.

**Stephan Feldgoise**: Yeah, look, the ESG theme is not just activism. It's every board, every discussion, every interaction we have with clients, including at Goldman Sachs, is thinking about the ESG angle. Activists have raised capital around the ESG theme. It's resonating with investors. It's giving activists platforms with which to gain traction with management teams and boards as they look to do what they do in terms of making change and having change happen at companies.

Now, the question, and I think there has been a lot written about this is what the returns be in ESG-focused funds and activist funds relative to traditional funds? And I think what we all hope that we're all very focused on ESG issues and the improvement of ESG issues, is that the returns will justify more capital, which will continue to support the ESG themes. But the debate is, you know, will those returns be there? When you think about power and energy as a very important and impacted ESG sector, how will ESG impact the returns of the investors in those sectors and even, you know, the activist funds that are taking positions. I mean, it's not just

about headlines. It's going to be about returns. And so, there is always a balance between returns and certain themes in terms of what's the balance between the two. But there needs to be, you know, solid ESG returns to continue the improvement in ESG. And I know a lot of folks within Goldman and others are focused on making that a positive return profile to continually improve ESG.

**Mark Sorrell**: I would add from an activism point of view, I think for me the interesting thing this year has been the number of very high-profile kind of activist situations around mega cap companies, both in the US and Europe. That's the thing that, I think for me, has come back that's interesting.

So, you know, by historical standards a very good number of very sophisticated complex attacks on, you know, large corporates. And so, I think for me, in addition to the ESG theme that Stephan talks about, you have the return of large-cap activism, which for me is very much focused around portfolio and portfolio mix. And back to the traditional kind of discounting some of the parts focus. And I think that is a theme. When we broaden it out away from activism, I think that is-- when you look at the quite noticeable uptick in structured M&A, i.e., spin offs and other structured divestitures, I think this is all part of a theme of a return of focus on portfolio, some of the parts, core versus non-core. And I think the activists are very much following that theme, which today also has an ESG overlay.

I think, you know, before it would be very purely value focused. I think now you see ESG as being part of that value thesis that you see activists pursuing.

**Allison Nathan**: Lastly, let me just ask you, Mark and Stephan, if you have some comments about the tax and regulatory environment. Obviously, it feels like it's shifting. Do you think that's going to impact M&A activity at all going forward?

**Mark Sorrell**: Yeah, so I think that clearly there is a shift going on. And by the way, in many parts of the world. Pretty much in all of the key M&A markets around the world there is a regulatory shift or a fiscal shift in some way. It's different in each place.

Now, I think there's a mix of, obviously, a change in administration in the US. A focus on national security in Europe. It's different mixes in different places. Themes coming out from exiting the pandemic. My personal view is, and I think Stephan alluded to this earlier, this is a real focus for, I think, corporate clients at the moment. I think it's a topic that's top of mind.

My personal view is if you look back at ten, 15, 20 years, there are shifts like this that happened. They're always, obviously, slightly different in nature. But there are shifts and different focuses. And the M&A market participants and practitioners have been very successful in adapting their approach or evolving to address these issues in a sensible way to be able to undertake the strategic activity they want to pursue. So, I think it is an issue. I think the market is very effective at evolving.

And then the other point I would make is, again, picking up stuff Stephan said, if you actually look at where the majority of activity is in the market, you know, the majority of activity is in the 500-million to 5-billion-dollar area, 7-billion-dollar area. So, there is a huge amount of activity of general M&A activity where this is really much less of a relevant theme as well. So, we shouldn't lose perspective on how much of an issue this is in terms of the overall market. Stephan, what would you add to that?

**Stephan Feldgoise**: Look, I mean, if you take tax specifically, there was some increased activity due to tax this year. I would say very much a minority issue in terms of people actually doing transactions. It was a consideration. But there are 20 considerations on the list when boards are thinking about things. And it was one of them.

Maybe for some families or others is it more relevant in a given year? But we've had tax movements for decades. And so, it's always a consideration in M&A. Much like regulatory. Regulatory is always a consideration in M&A. And it continues to be. And, you know, it's one of the issues you work through and think through and manage with clients as they think about M&A transactions.

So, I don't see a fundamental change in the landscape of the environment, of which tax and regulatory are two components relative to history. You know, I mean, my goodness, we just dealt with and are dealing with an unbelievable pandemic and M&A is at all-time highs. And the pandemic reached scope and scale and impact on lives in humans in the world in ways that any crisis has ever done. And companies continue to focus on growing the businesses, managing it. You know, we did hundreds of transactions 100 percent virtually last year. I mean, to consider that the year before and say that you're not going to meet with clients and still do hundreds of transactions, I think Mark and I would have had an interesting conversation about if that was even feasible. And we did. But we adapted. Clients adapted. The teams adapted. And that's what our jobs are and that's how we help clients, and clients are the managers of risk and situations as well. And then that's what you see happen, whether that be tax, whether it be other issues and risks.

**Allison Nathan**: Thanks so much for the update Stephan and Mark. Always great to have you on the program.

Mark Sorrell: Pleasure.

**Stephan Feldgoise**: Thank you.

**Allison Nathan**: That concludes this episode of Exchanges at Goldman Sachs. Thanks for listening. And if you enjoyed this show, we hope you subscribe on Apple Podcasts and leave a rating and comment.

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