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2021 Forecast for UK M&A and IPOs: Delayed Gratification?

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Many commentators predicted a boom in M&A and initial public offerings (IPOs) in the U.K. in 2020, a year that proved making predictions is a risky business. As we enter 2021, however, there are good reasons to believe that the worst of the pandemic will soon be behind us and we can be optimistic about the markets again. Strong signs indicate an appetite for large mergers, and the trillions of dollars held by fund managers set the stage for a revival of the IPO market.

Global M&A got off to a good start in 2020, with the €17.2 billion buyout of ThyssenKrupp's elevators business by an Advent- and Cinven-led consortium in late February 2020 and Aon's $30 billion acquisition of insurance broker Willis Towers Watson 10 days later. By the end of the quarter, however, the effects of the pandemic were being felt. Activity was down 35.3% by value[1] from the previous three months.

The slump was even more pronounced in the second quarter, when Virgin Media's $12.6 billion merger with O2 was the only deal worth more than $10 billion in Europe. Overall, global M&A volume fell to $318.6 billion in the second quarter, the lowest level since 2003, with Europe accounting for $66 billion. However, volume rebounded in the third quarter, reaching $785.6 billion globally and springing back to $189 billion in Europe.

The U.K. IPO market struggled all year. At the end of February 2020, the owners of IQ Student Accommodation, who were reported to have been considering an IPO, opted instead to sell the company to Blackstone for $6.2 billion. And that was before the global health crisis. By November 2020, there had only been 17 IPOs all year on the London Stock Exchange (LSE), according to Barclays — seven on the Alternative Investment Market and 10 on the Main Market. Of the 17 IPOs, 12 priced post-October 2020, demonstrating how much activity was skewed toward the end of the year. That was a 40% decline from 2019, which itself saw the fewest listings since 2009. Only two companies achieved IPO valuations above £1 billion ($1.36 billion) during this period: smart meter maker Calisen in February 2020 and The Hut Group, an e-commerce company, in September 2020. The Hut Group IPO alone accounted for 40% of total U.K. IPO volume for the year.

Notably, and possibly portentously, The Hut Group came to market with an unorthodox governance arrangement (including a dual-class share structure), such that it was only entitled to a standard, as opposed to a more prestigious premium, listing. Difficulties faced by the LSE in attracting and retaining listings, in particular for high-growth, tech and founder-led companies, has triggered a review by the U.K. government of the U.K. Listing Rules. The LSE and the City of London are encouraging an overhaul by looking at issues including minimum free float requirements and dual-class share structures. A report of the review is due in the first few months of 2021.

Given a rollercoaster year for M&A and a poor showing for IPOs in 2020, why be optimistic for 2021?

First, M&A markets seem to be recovering, as evidenced by the turnaround in third-quarter numbers and the strong finish to the year. The fourth quarter started well, with the $9 billion acquisition of the Asda supermarket chain by the entrepreneurs Zuber and Mohsin Issa and TDR Capital being announced in October

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2020 and the $44 billion purchase of financial data provider IHS Markit by S&P Global in November 2020. The final months of 2020 also saw takeover bids for Codemasters Group Holdings plc, among others. The end result was that the value of European M&A for 2020 reached $785 billion, which represented a healthy 29% increase over the $607 billion for 2019.

Second, while IPOs were scarce in 2020, equity capital-raising was not. The Pre-Emption Group, which represents U.K. institutional investors, relaxed its guidelines in April to give listed companies greater flexibility to issue new shares, and a flurry of issues followed. A survey by financial services firm Goodbody showed that as of October 30, 2020, 463 LSE-listed companies had raised a total of $35 billion of new capital during the year, the highest level since 2009. In most cases this funding came from existing shareholders, but a number of companies participated in high-profile PIPE (private investment in public equity) deals, with publicly traded Aston Martin, Costain, SIG and Saga each attracting private capital.

These equity raises provided existing companies with liquidity to see them through the pandemic. If many businesses stabilize, there will be less demand for secondary issues, and equity investors with capital to deploy will be on the lookout for new companies that may pursue IPOs in 2021. The success of the Hut Group IPO — the company's valuation rose from $7.3 billion at the time of its offering to $10.4 billion by year-end — should make investors more willing to participate in IPOs for companies with a promising outlook, even if their governance structure is less conventional.

Third, the availability of capital in the public markets reflects the state of the debt and private capital markets. It has become a cliché to cite the amount of "dry powder" held by private equity, debt and other alternative fund managers, but the figures remain astonishing. Financial data provider Preqin noted in a report issued at the end of November 2020 that aggregate assets under management were forecast to be slightly lower at the end of 2020 than 2019 (down to $10.7 trillion from $10.8 trillion) but predicted that the figure would reach $17.2 trillion in 2025. That capital will need to find a home.

Fourth, our overall optimism is not dampened by the fact that there are likely to be many restructurings in 2021. The U.K. saw high-profile retailers, including Arcadia, Debenhams and Peacocks, enter formal insolvency proceedings during 2020. New failures will take a toll on employees and suppliers, but not all the troubled businesses will cease to exist. Some will be sold to new owners who hope to turn them around, and others will be able to raise new capital to restructure and survive.

Finally, with COVID-19 vaccinations underway, it seems reasonable to believe that, by the middle of 2021, prevention will be well advanced. If that proves right, the recovery can begin creating new opportunities for buyers, sellers and investors.

Although the unpredictability of 2020 shows how challenging predictions can be, 2021 seems likely to be a stronger year for U.K. M&A and IPOs.

[1] All M&A value data sourced from Refinitiv.