Mergers and Acquisitions Report

M&A Market Takes a Sick Leave

The COVID-19 pandemic has disrupted the M&A market to an extent even greater than the financial crisis of 2008. The economic uncertainty brought on by the pandemic has forced many bidders to adopt a cautious approach towards mergers and acquisitions. In many industries, dealmaking has slowed to a crawl as companies wait until the pandemic subsides and the dust settles. It will likely take years before M&A activity sees a return to pre-COVID levels.

This report presents an overview and analysis of the M&A market leading up to the pandemic, how COVID has affected M&A in 1H20, short and medium-term predictions for the M&A market, and an analysis of a recent acquisition.

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Mergers and Acquisitions Overview

What is Mergers and Acquisitions?

Mergers and acquisitions (M&A) refers to transactions that involve the buying and selling of a company, its divisions, or assets. Mergers involve two companies of relatively similar size, while acquisitions usually mean the buyer is significantly larger. They both imply transfer of control of a firm or asset from one group of shareholders to another but give rise to certain differences. For example, in mergers, 100% or majority stock deals are far more common because a company rarely, if ever, has enough cash or debt capacity to acquire another company of similar size.

There are three broad categories of M&A, as determined by source of value:

1) **Strategic acquisitions:** These are driven by operating synergies, where the combined firm value exceeds the sum of the individual firms. These are usually horizontal acquisitions and are pursued because they result in higher earnings or cash flows, from increased revenues or reduced operating costs.

2) **Financial acquisitions:** These are driven by financial motives such as an under-valued firm or asset because of poor management or temporarily price dislocation, under-utilization of tax shields or debt capacity (I.e. inefficient capital structure), and problematic management compensation structure (Agency problems).

3) **Conglomerate acquisitions**: These are driven by an attempt at diversification or risk reduction. These have fallen out of favor because evidence suggests they destroy shareholder value. Additionally, the market provides investors with sufficient diversification opportunities.

Ultimately, companies focus on transactions that are **accretive** to EPS (A major investor concern) and that have a reasonable asking price from the Target (I.e. an acceptable premium).

From the perspective of an investment banker, there are two types of transactions, sell-side M&A (Advising the target), and buy-side M&A (Advising the acquirer). An investment banker in M&A, will spend time building valuations and modeling potential synergies, creating different case and deal scenarios (I.e. sanitizing the deal for purchase prices, cost synergies, financing).

Mergers and Acquisitions considerations

There are three major steps in the acquisition process:

1) The valuation of the target and the synergies that will result from the acquisition.

2) Calculation of the premium.

3) Determining the financing method (Cash, stock, or a combination of both).

Synergies create value by harvesting benefits from an M&A that the company would be unable to gain on its own. For example, the economies of scale from an M&A might reduce average operating costs (i.e. a cheaper option than organic growth). There are two types of synergies, **operating synergies** and **financial synergies.** Operating synergies result from economies of scale and scope, learning curve, operating improvements, greater market power, and better bargaining positions with suppliers. Financial synergies result from a higher debt capacity, a reduced tax bill if the target has net operating losses (i.e. tax loss carryforwards), and a lower cost of capital.

The determination of the premium is important, because if it is too low, the offer will not be taken seriously, and it will reduce the probability of the acquisition being completed. If the premium is too high, it will result in a negative-NPV decision, and there will be a transfer of wealth from acquirer shareholders to the target's shareholders. Historically, controlling interest premiums have ranged around 40% to 50%. It is often finalized via negotiations and depends on several factors such as synergies, the number of bidders, and any anti-takeover provisions such as a poison pill.

The form of payment is important because it significantly impacts shareholder event returns. There are various factors to consider such as tax Implications (Cash financed acquisitions are treated as a sale of shares and incur capital gains), the capital structure (Stock financing is more common if the acquirer has too much debt), the target firm's size (Stock financing is more common if the target is of similar size), impact on EPS (Stock financing is limited by EPS dilution), the liquidity of the acquirer (Insufficient liquidity will minimize cash financing), and recent stock price performance (A rising stock price makes stock financing more desirable).

1H20 Trends in the U.S. & North America

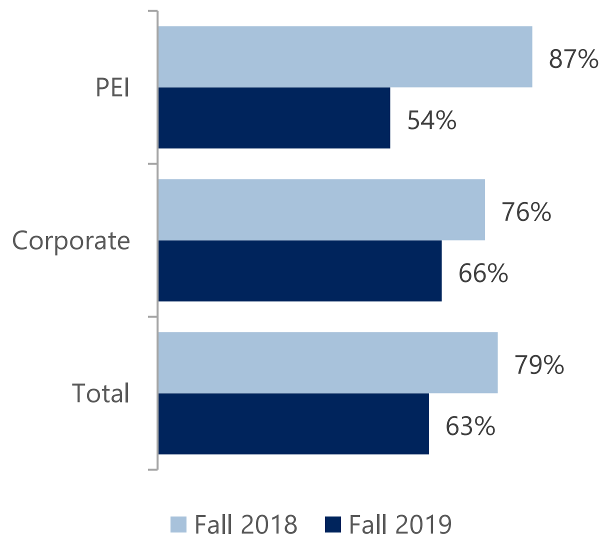
Before the Pandemic

The COVID-19 pandemic is having an unprecedented impact on mergers and acquisitions, particularly in the North American market. Prior to the pandemic, however, dealmakers predicted only a minor decline in M&A activity. 63% of respondents from a Deloitte survey had predicted higher transaction activity – a lower statistic than the 79% in 2018, implying lower confidence and a less enthusiastic outlook of the M&A Market.

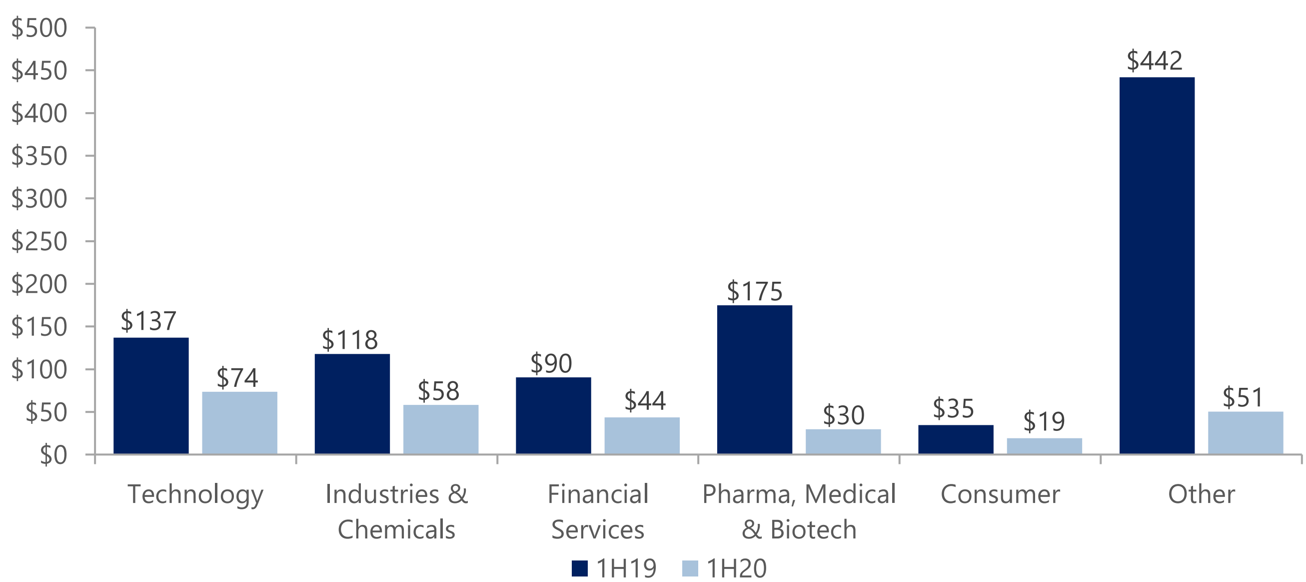
Although COVID-19's impact has resulted in greater uncertainty for dealmakers, the current downward trend for dealmaking is similar to 2019, which had a QoQ decline of 6% by volume and 36% by value from 1H19 to 2H19. This is mostly due to political and economic tensions influenced by the uncertainty in global markets, further explained on Page 8 (Short-term outlook).

Overall, 2019 M&A deal value in North America remained strong, despite a minor decrease in deal volume from USD $1.6T (7,033 deals) in 2018 to USD $1.7T (6,493 deals) in 2019. In comparison to 1H19, 1H20 deals in the U.S. have taken a substantial hit, particularly in miscellaneous industries ("other"), with deal value declining a staggering 88%.

Greater uncertainty in 2019 lead to a decline in expectations in the average number of deals in 2020



U.S. Deal Value by Sector (USD$B)



Source: Mergermarket, Global & Regional M&A Report 1H20, Deloitte 2020 M&A Trends Report

M&A Market Takes a Sick Leave

COVID-19's Impact on Deal Activity

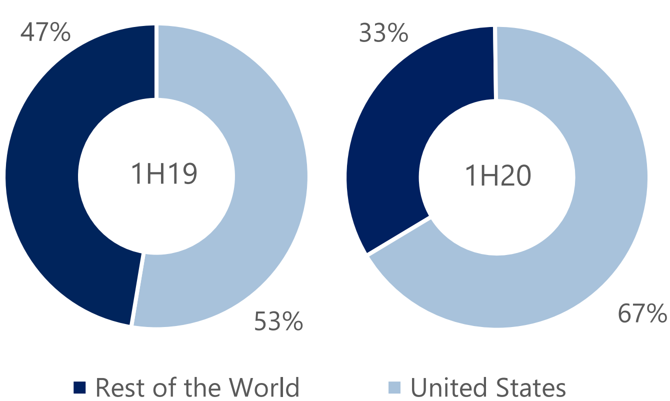
After nearly a decade of relatively steady growth, M&A activity has steeply declined due to the COVID-19 pandemic, particularly in North America. The effects of COVID-19 were so significant in the M&A market, that some of the largest U.S. transactions have been postponed, including Xerox's takeover of HP, Woodward Inc.'s merger deal with Hexcel Corporation, and Simon Property Group's acquisition of Taubman Centers. These anecdotal stories are part of a larger trend this year. In North America, deals declined by 35% in volume and a staggering 73% in value in 1H20 (2,287 deals worth USD $286B) compared to 1H19 (3,520 deals worth USD $1T). North American M&A has taken a substantially larger hit than the rest of the world in this regard, as total global M&A activity only declined by 53% in value year over year.

Over half (55%) of respondents to a Baker Tilly's survey on M&A, say they will be decreasing investments in North America, only 18% of respondents said that they would be moderately increasing investments. The negative sentiment was strongest towards the U.S., where the COVID-19 case count is the highest in the world. 42% of respondents said they would be significantly scaling down investments south of our border. An inadequate response to the pandemic and its subsequent impact on financial markets, along-side fear of an upcoming recession were among the top reasons sighted for decreasing investment in the U.S. 87% of respondents said that the pandemic had a negative impact on their decision to complete M&A as well as investments in North America. This negative sentiment and decreased investment in U.S. has reduced its total M&A market share from 52.8% in 1H19 all the way down to 33.4% in 1H20, a 33.7% reduction in market share.

Why COVID-19 is So Disruptive to M&A

There are several factors that make COVID-19 so disruptive to M&A. The first of these is the Material Adverse Change (MAC) clause that is embedded in merger agreements. Transaction agreements usually have a MAC clause that permits the buyer to terminate a transaction when an event materially and adversely affects the target company. Many purchasers have successfully argued that the pandemic qualifies as such an event and have subsequently cancelled their transactions. The pandemic is also making share prices extremely volatile, which can severely complicate the valuation process, and sometimes the payment for M&A transactions, causing acquirers to hold back on dealmaking until share prices stabilize. Leveraged buyouts are also going to be very complicated to conduct going forward, as uncertainty about economic reopening and consumer behavior makes accurate cash flow predictions, and thus EBITDA-to-debt ratios, nearly impossible to predict with accuracy. All of these factors make M&A right now extremely challenging to complete.

Decline in American Market Share of Global M&A



Sources: Baker Tilly, Bennet Jones, Morgan Stanley

What Industries Are Thriving?

Although some industries have experienced many hardships as a result of the pandemic, others have thrived or have had less disruption as business is starting to pick up.

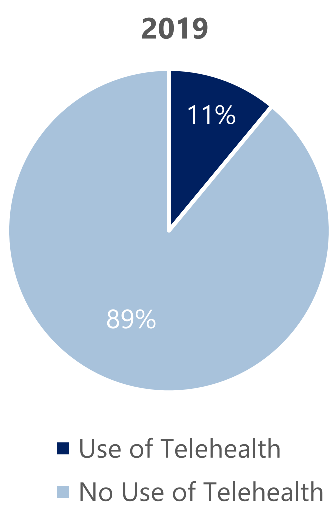
The technology sector started making a comeback in the M&A environment around May-June, especially in industries such as telemedicine. Thanks to the pandemic, the telehealth sector is accelerating greatly, with a high consumer adoption rate of 46% in the U.S. alone. Consumers are now finding ways to reduce in-person appointments, and instead, accepting virtual methods of maintaining and improving their health. A study through McKinsey indicates that 11% of consumers in 2019 used telehealth in comparison to their newest study this year, where 76% of consumers are now interested in making use of telehealth. Healthcare providers may start to consider different approaches to their services as this industry develops over time.

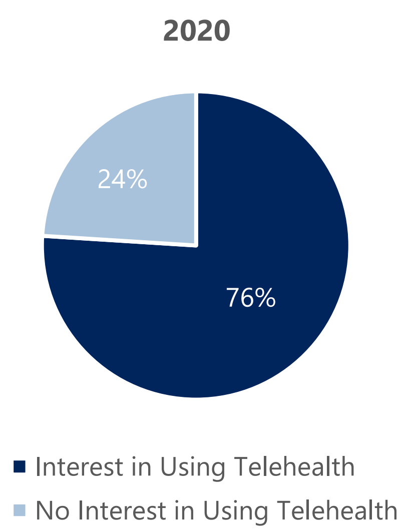
Much larger tech deals have been arising lately with companies such as Cisco Systems' acquisition of ThousandEyes, an IT provider, as well as Panasonic Corporation's acquisition of Blue Yonder Group, a retail software and service provider. In response to heightened political tensions between the U.S. and China, there have also been conversations about the acquisition of TikTok/Douyin by Microsoft, or Oracle. TikTok is a Chinese video-sharing platform that has gained significant popularity since its rebrand and migration from Musical.ly. As of August 2020, Microsoft is favored to make an offer to TikTok's parent company ByteDance, ensuring U.S. ownership and reducing national security risks.

Food delivery companies and software handlers are now experiencing an increase in demand and therefore, showing a larger presence in the M&A markets. Some of the most recent deals include Just Eat's merger with Grubhub for USD $7B, as well as DoorDash's USD $400M raise, raising their overall company value to USD $16B.

How has COVID-19 Changed the Outlook for Telehealth?

The Consumer's Perspective





Source: McKinsey & Company – Telehealth: A quarter-trillion-dollar post-COVID-19 reality?

Deal Drivers

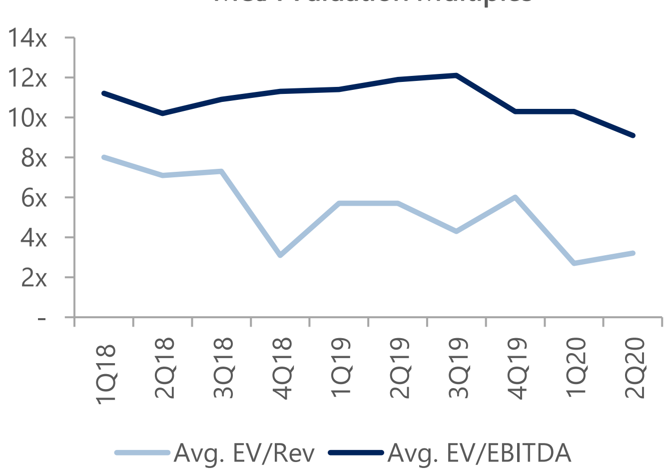
Distress Driven M&A

Prior to the outbreak of the novel coronavirus, the North American market was expecting increases in distressed M&A activity throughout 2020. Increasing US-China trade tensions, populism concerns, and fears of a slowdown that would end the long-bull run gave rise to predictions of a market correction. Today, as companies struggle with lost revenues from operational interruptions and disrupted supply chains, it is even clearer that distress-driven deals will be a key M&A driver in the remainder of 2020, continuing deep into 2021. The largest distress driven deal increases may occur in industries such as retail, leisure facilities, accommodation and real estate. These increases are expected to continue until financial conditions in NA stabilize and business revenues are no longer impeded by quarantines and lockdowns.

Depressed Valuations

Public company valuation multiples have contracted significantly (-21%) so far in 2020 and private company multiples are expected to decline by similar amounts. Insolvent companies and those in challenging markets will be undervalued.

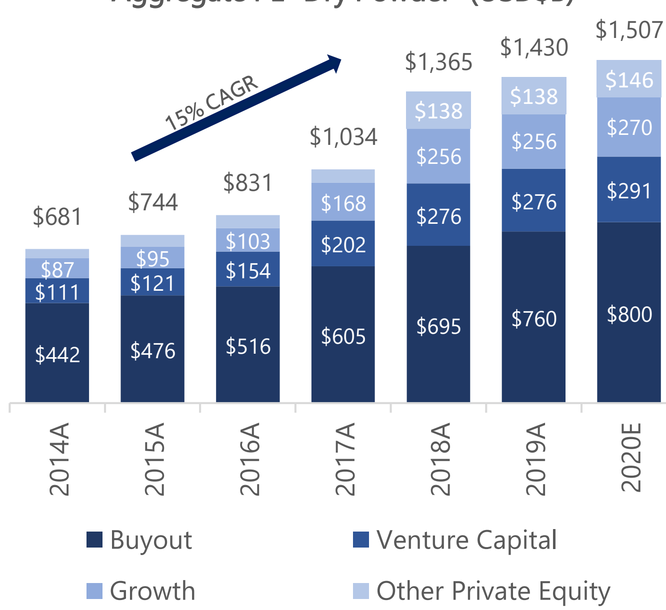
M&A Valuation Multiples



Private Equity Spotlight

Private equity (PE) firms are expected to be more aggressive than strategic acquirers during this period of uncertainty, due to unprecedented levels of dry powder and evidence of above average returns from down cycle investing. Many private equity firms missed out on major investment opportunities presented during the 2008 financial crisis. The debt market collapse may have taught PE firms a historical lesson; studies show that PE firms who invest steadily in economic down cycles have outperformed their peers. Global private equity is currently sitting on a record level of $1.5T in dry powder. Financial buyers are positioning themselves to deploy this capital quickly in the short-term as opportunities arise.

Aggregate PE "Dry Powder" (USD$B)



However, financial buyers' large reliance on debt capital may prove to be an issue in the coming months. An increasing cost of debt and lenders' reluctancy to deploy pre-COVID levels of leverage may create challenges in raising funds and finding buyers willing to pay the desired valuations. PE firms will be unable to achieve the same target ROI's at previous acquisition multiples. Despite increasing capital outlay costs, we can generally expect bolder, more aggressive investment strategies from PE firms in the next year.

Source: Livingstone, Mid-Year M&A Update, RBC

Short-Term Outlook for 2H20 - Deal Challenges

The 59th U.S. Presidential Election

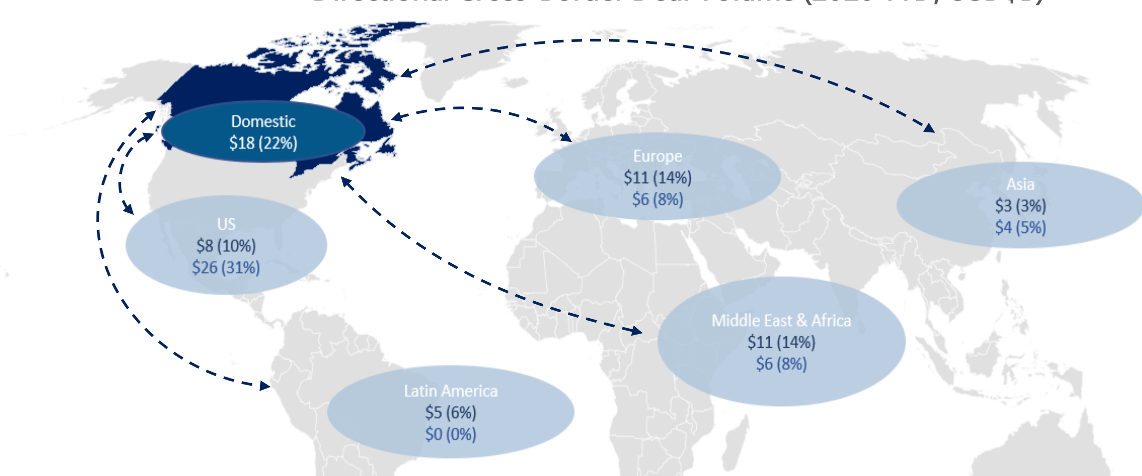
The COVID-19 pandemic has significantly impacted M&A in the first half of 2020. The upcoming U.S. presidential election, ongoing geopolitical challenges, current recession, and the coronavirus outbreak all threaten to prevent deal making in the remainder of 2020. Deal makers will be adopting a cautious approach towards new acquisitions, and it is expected that significant amounts of M&A activity will be abandoned or postponed until 2021, like the Taubman or Victoria's Secret acquisitions. Financial buyers will have more active deal flows than many strategic buyers, who remain hesitant in pursuing acquisitions given uncertainties in their own businesses. Buyers are looking for political and economic stability; luxuries that will not be available in 2H20.

Given the recent polarized nature of political discourse in the U.S., this fall's upcoming election could have particularly damaging economic effects. Historically, both the 2011 and 2015 election cycles had contracting effects on both the volume and value of M&A transactions versus the year prior. We expect a notable hitch in deal activity as the U.S. election season approaches and passes in November.

Geopolitics and Protectionism

Cross-border deals have recently decreased amid political tension concerns and rising protectionism in the U.S., and the COVID-19 outbreak has only sped up these declines. Protectionism has pushed away international deal makers; non-US buyers are expected to prioritize regional opportunities closer to home as a result. Canadian inbound and outbound cross-border M&A activity has decreased by 35% and 66%, respectively. U.S. investors will also be turning inward due to uncertainty surrounding troubled U.S.-China relations, as the Trump administration places nearly USD $5B of tariffs on Chinese medical supply imports. These actions are uniquely expected to potentially extend the duration and severity of the pandemic as trade restrictions drive up prices, create artificial scarcity, and lower the quality of global health care. Protectionism is here to stay for the foreseeable future and will likely continue at current paces if the Trump administration earns a second term in the coming fall. This will have a significant global effect on cross-border M&A activity in the remainder of 2020.

Directional Cross-Border Deal Volume (2020 YTD, USD$B)



Inbound (Foreign Acquirer/Canadian Target)	$29	(35%)
Outbound (Canadian Acquirer/Foreign Target)	$37	(66%)
Domestic (Canadian Acquirer/Canadian Target)	$18	(57%)

Changes from 2019 YTD

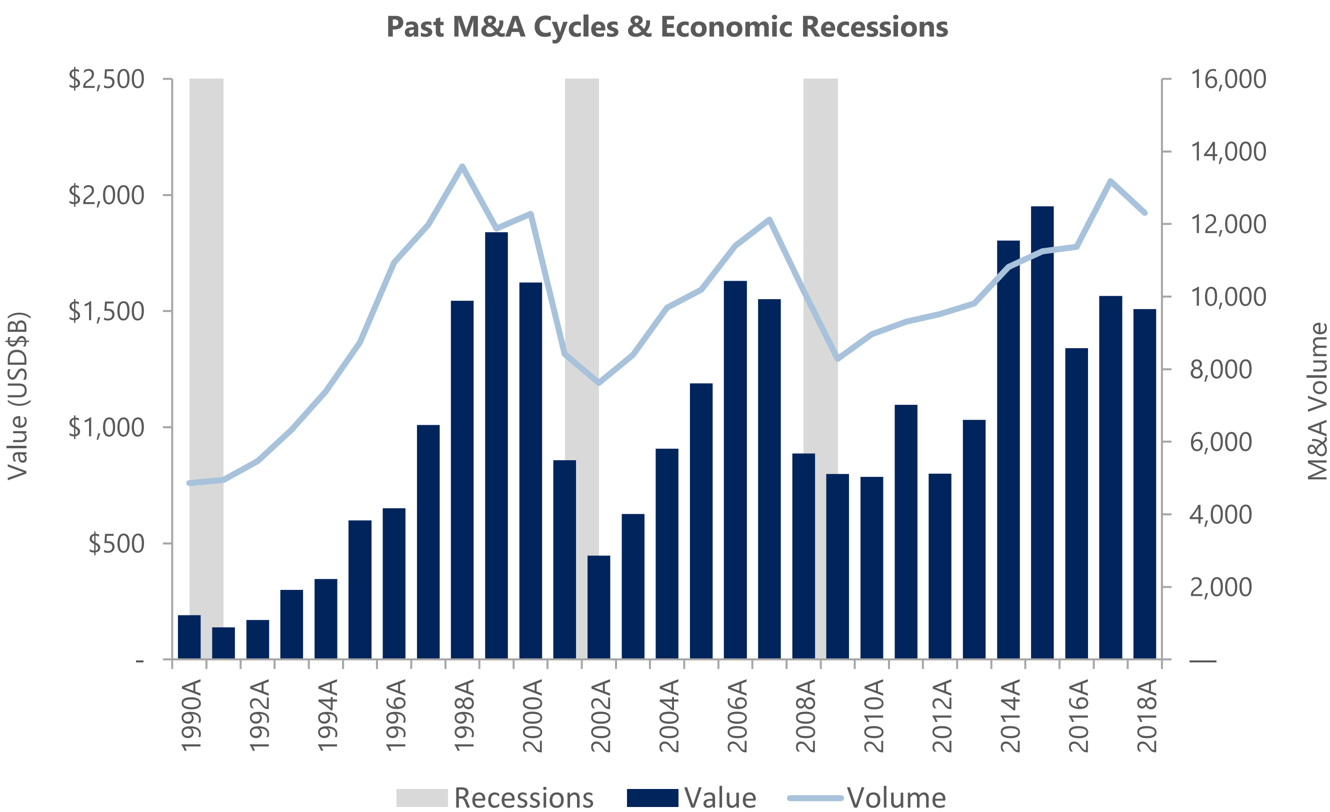
Source: Bloomberg, 2020 figures current to June 18, 2020

Long-Term Outlook

Long-Term Economic Effects – A Look at the Past

A good way to understand current M&A trends is to analyze historical data, notably the three most prominent downturns of the last 30 years: the 1990-91 Recession, the Dot-com bubble of 2001-02, and the Financial Crisis of 2008-09. In all three of these downturns, M&A volumes decreased between 40 and 60%, the 1990-91 Recession having the most significant downturn and the Dot-com bubble and the Financial Crisis have had relatively similar declines in M&A volume. Historically, we have seen recovery times of ~3-4 years before M&A activity had returned to its normal levels. Some savvy dealmakers have benefited from these downturns by capitalizing on lower valuations and more diverse transaction types, such as using higher leveraged ratios, looking into minority investments and partnerships, and the use of more non-cash structures.

Although COVID-19 may be categorized as a short-lived phenomenon, these three points in time have demonstrated significant drops in M&A that could provide financial advisors a better understanding as to how companies might function if another crisis occurs, and how quickly they can adapt to changes in the business environment. Many dealmakers have expressed different points of view in terms of resuming M&A activities, the overall direction of the economy, and what stages that the M&A Market might go through before its full recovery. These highlight the increased uncertainty and the unprecedented global shutdown brought about by COVID-19.



Source: PwC - Succeeding through M&A in uncertain economic times

Long Term Outlook: Scenario Analysis

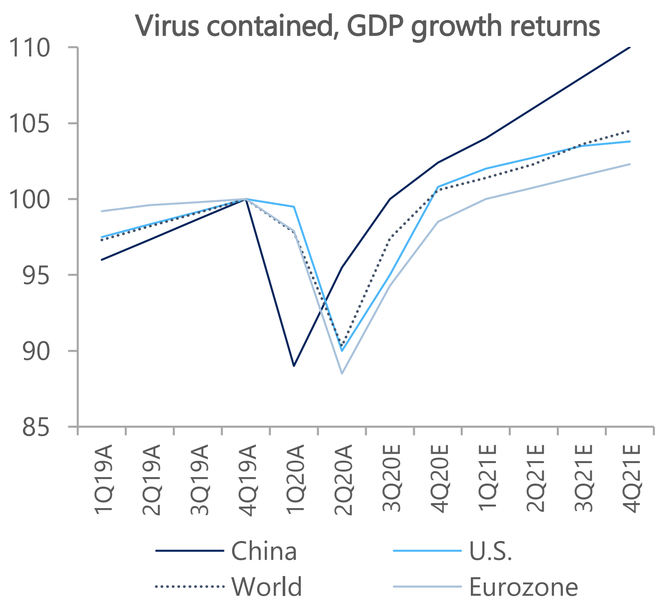
Recovery will take time. The rate at which North America recovers from the current recession and its eventual return to pre-COVID M&A levels will depend on the economic volatility, the coronavirus response, and the prevailing macroeconomic outlook in each respective industry.

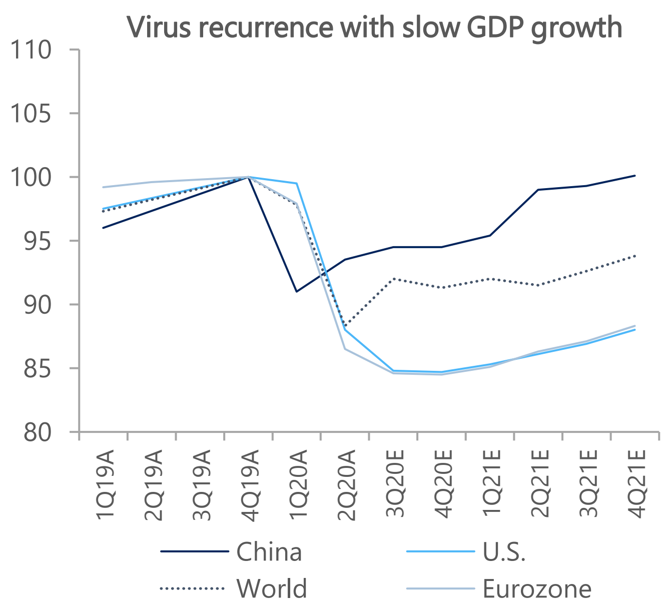
Optimistic Scenario

The public health response in North America in the next 4-6 months suppresses the virus effectively. Improved treatment methods and control drugs help prevent further spread of the virus. Hopes of a return to normalcy appear as a viable vaccine becomes available in the next 8-12 months. North American economies continue to reopen at current pace with limited pandemic resurge consequences. Record unemployment rates continue to trend down at ~-1% per month in a return to February levels. Strategic economic policy, low interest rates and higher economic expenditures prevent further structural damage to the economy. Pre-pandemic fundamentals and momentum is restored, increasing market confidence and a solid platform for M&A recovery. An optimistic M&A recovery with a rapidly recovered financial sector would see current deals, primarily with buyers generally unaffected by COVID-19, processed. As the pandemic is controlled, M&A activity will be led by PE and companies performing well in the pandemic. Deal makers are optimistic and confident and a return to pre-COVID levels of activity would occur in the next 12-18 months.

Pessimistic Scenario

Government actions are ineffective in controlling current infection rates. Public health's ineffective response to fall spikes causes further resurgence in NA coronavirus cases. Vaccine research and trials are ineffective, and a viable treatment does not arrive. Economic outcomes due to a lack of public health recovery would be severe and cause the economy to struggle. The economy could potentially see an unprecedented contraction. Economic policy and intervention would fail to prevent continued spikes in business closures and record unemployment rates. Potential border reclosures due to increasing political tensions and fall outbreaks continue to decrease cross-border M&A activity. Dealmakers are less optimistic about resuming M&A activity due to uncertain recovery. It could take up to two years before the economy sees a return to 2019 GDP levels and more than 5 years for the most damaged sectors, such as entertainment, accommodation, travel, and transportation. Uncertainty and skepticism plague the M&A scene with a recovery timeline to pre-virus levels of 2 to 4 years.





Source: McKinsey, U.S. recovery after the COVID-19 Crisis

Transaction Analysis: Hostess Brands LLC Acquires Voortman Cookies Ltd.

Transaction Summary

Announcement Date: December 2 ,2019
Closing Date: January 3, 2020
Acquiring Company: Hostess Brands LLC

Target Company: Voortman Cookies LTD
Transaction Value: USD $320M
Post-Synergy Multiple: 9.1x EV/EBITDA multiple
Pre-Synergy Multiple: 16.0x EV/EBITDA multiple

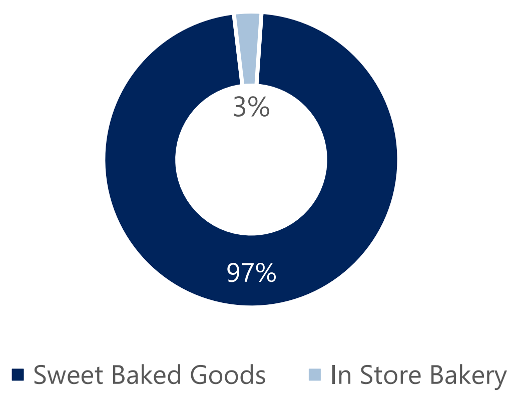
Acquirer Company: Hostess Brands LLC

Description:

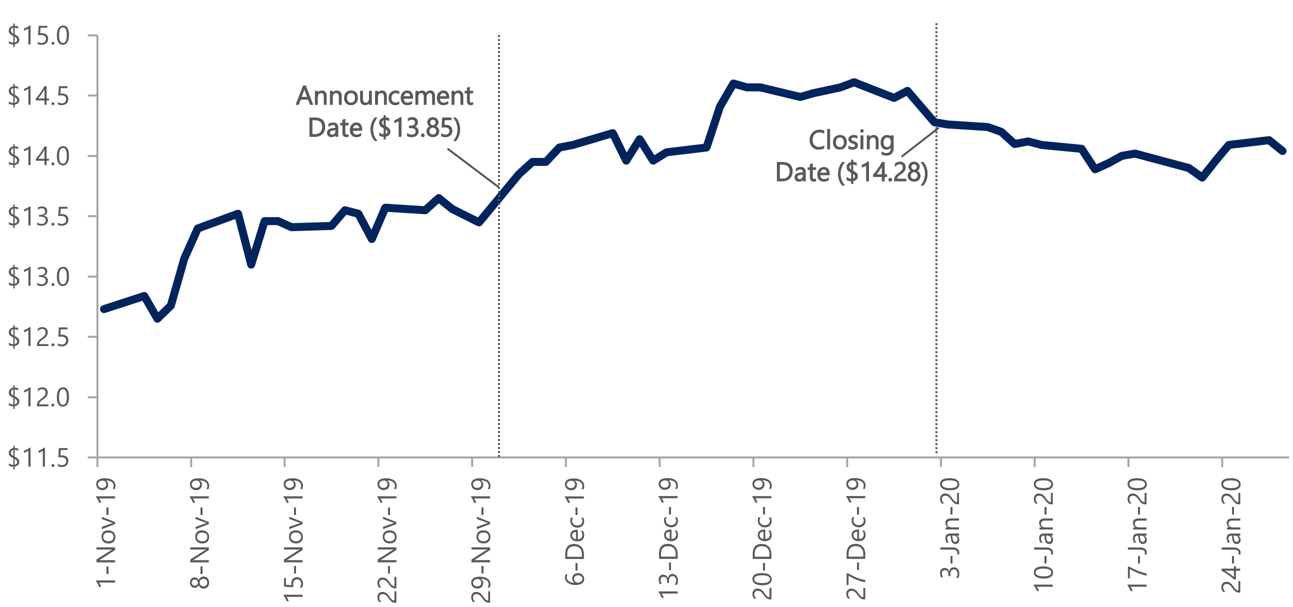
- Hostess Brands is an American Bakery company formed in June of 2013. It owns several bakeries in the U.S. that produce snack foods under the Hostess and Dolly Madison brand names.

- Hostess shares closed at $13.85 on December 2, 2019, the day the acquisition was announced. The stock climbed over the next month, closing at $14.28 on January 3, 2020, the day the deal closed. The share price has since fallen to $12.72 (as of August 8, 2020).

Revenue Breakdown by Segment



Hostess (TWNK) Stock Price - November 2019 - Jan 2020



Source: Duff & Phelps, Voortman Cookies 2019 Acquisition Report, Hostess Brands 2019 Report

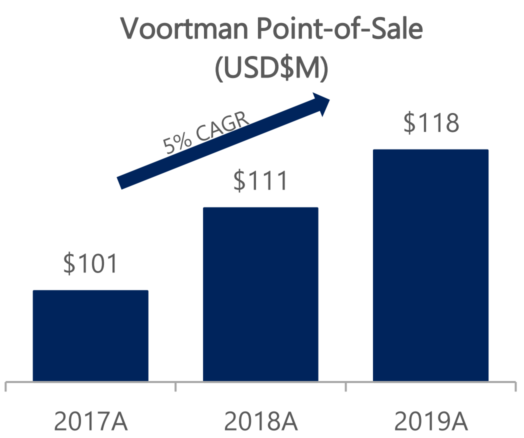
Target Company: Voortman Cookies LTD

Business Description

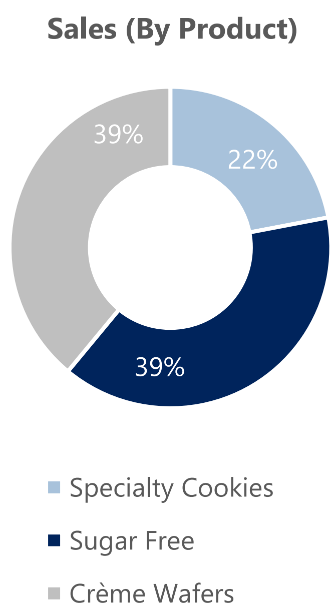
- Voortman Cookies LTD is a Canadian company, based in Hamilton Ontario, specializing in the production and sale of cookies. Voortman cookies are sold in over 72 countries worldwide.
- Net revenue of approximately USD $90M in 2020
- Adjusted EBITDA of approximately USD $20M in 2020, projected to be USD $40 to $50M by 2022
- Annual run-rate synergies of at least USD $15M within 12-18 months
- #1 Market Share in Wafer and Sugar Free Cookie Segments
- Growing at 5.1% CAGR over the last 3 years
- Predominantly sells products in North America

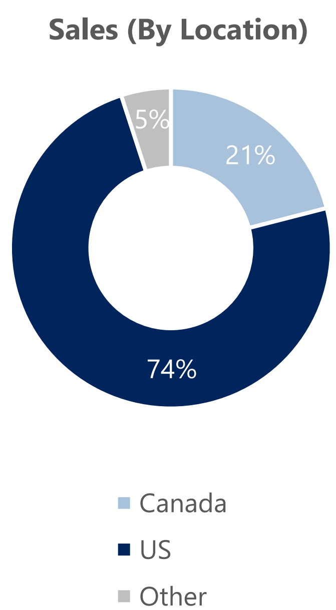
Financial Overview

EV	$319.8M
LTM EBITDA	$20M
EV/EBITDA	16.0x



Revenue Breakdown





Source: Voortman Cookies Limited – Acquisition Report, December 2, 2019

Transaction Analysis

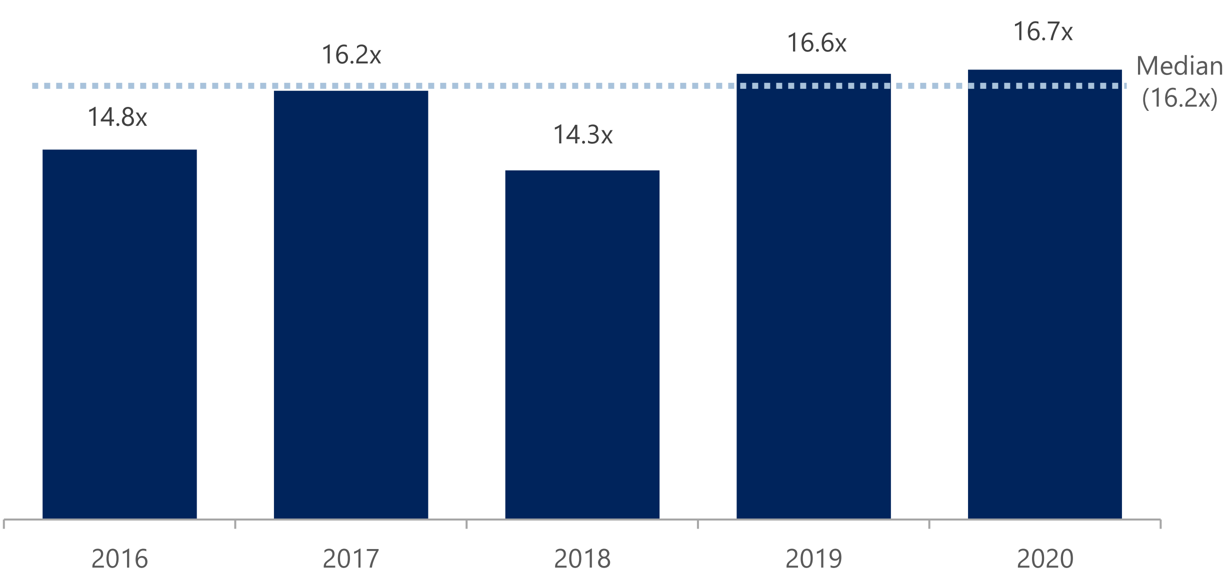
Industry Standards & Hostess Brands Strategic Reasoning

According to the Duff and Phelps' "Food and Beverage M&A Landscape – Winter 2020" report, the median EV/LTM EBITDA multiple for confectionary/snack acquisitions is 16.2x over the past five years. The multiple in this space have been trending upward for the last five years, starting at 14.8x in 2016 and moving up to 16.7x this year. One possible reason that multiples in this industry have been trending up is the rapid growth in the snack industry, from USD $125B in 2017 to USD $150B in 2019. The industry is estimated to continue growing from a range of USD $30B to USD $180B by 2022.

Based on our analysis of the transaction and the industry, we have concluded that Hostess made a sound strategic decision in buying Voortman at the time and price that they did. Hostess was able to purchase Voortman at an EV/EBITDA of 16x – just below the industry average. Voortman Cookies has had a 5.1% compound annual growth rate over the past 3 years, which is far ahead of the 1.8% overall growth rate in the cookie category, making them the fastest growing independent sweet snacking brand. Hostess Brands expects that this acquisition will improve the gross margins, EBITDA margins, and earning per share.

Ultimately this is a great way for Hostess Brands to extend its influence in the North American market. Hostess Brands was already a powerhouse in the snack industry before this transaction, owning brands such as Dolly Madison Bakery, Twinkies, and, of course, the Hostess brand itself. By acquiring a company with well know products in a growing industry at a price below industry standard, Hostess Brands is making it clear that they will continue to be an influential player in the snack industry in the years to come.

Average EV/EBITDA Multiple for Confectionary/ Snack Acquisitions



Source: Duff & Phelps, Food and Beverage M&A Landscape

Acquisitions to Watch

Uber Acquires Postmates

Announcement Date: July 6, 2020

Bidder Company: Uber Technologies, Inc.

Target Company: Postmates Inc.

Transaction Value: USD $2.65B

Description: Uber is continuing to assert its dominance in the food delivery market with its acquisition of meal delivery service Postmates. This comes after Uber's offer to acquire Grubhub fell apart due to concerns over US antitrust legislation. The Postmates app will continue to operate independently but will be able to use Uber Eats' merchant delivery system. This acquisition makes strategic sense for Uber, as it needs its meal delivery service to become more competitive, due to it rideshare service declining by 80% in volume due to the COVID-19 pandemic.

Just Eat Takeaway Acquires Grubhub

Announcement Date: June 10, 2020

Bidder Company: Just Eat Takeaway.com NV

Target Company: Grubhub Inc.

Transaction Value: USD $7.3B

Description: The Amsterdam based meal delivery service, Just Eat Takeaway, is breaking into the US market with its acquisition of Grubhub, allowing them to further capitalize on the surging demand for at-home delivery services amid the COVID-19 pandemic. As previously mentioned, Uber had intended to purchase Grubhub, but the deal was scrapped due to antitrust concerns. Just Eat Takeaway took advantage of this, swooping in to acquire Grubhub, while Uber acquired the smaller Postmates.

Amazon Acquires Zoox

Announcement Date: June 26, 2020

Bidder Company: Amazon.com, Inc.

Target Company: Zoox

Transaction Value: USD $1.2B

Description: This year Amazon invests more into self-driving car industry, shelling out over a billion dollars to acquire autonomous vehicle developer Zoox. Zoox has been developing a bi-directional vehicle with no steering wheel or discernible front or back end. This is the second major investment that Amazon has made in the self-driving vehicle industry, as last year they invested in autonomous tech startup Aurora Innovation during a funding round. With this latest acquisition of Zoox, Amazon seems to be preparing to seriously compete with the likes of Google, Tesla, and GM in the self-driving car industry.

Intuit Acquires Credit Karma

Announcement Date: February 24, 2020

Bidder Company: Intuit Inc.

Target Company: Credit Karma Inc.

Transaction Value: USD $7.1B

Description: American business and financial software company, Intuit, is the owner of TurboTax, QuickBooks, and various other financial software products. Intuit is extending its influence in the financial software space by acquiring Credit Karma, a personal finance service with over 100 million users in the US, Canada, and the UK. Credit Karma allows users to check their credit scores, shop for credit cards and loans, file taxes, and more. This is the first major acquisition to be made by CEO Sasan Goodarzi and is the sixth product offered by Intuit.

Sources: Uber, The Verge , Forbes, Bloomberg, Tech Crunch, Morgan Stanley