COMMENTARY

January 21, 2021

Dear Clients and Colleagues:

Early reports about COVID-19's impact on marriages in the United States (US) indicate that marriage rates were lower than expected in 2020[1]. Recent trends show that the opposite has been true for corporations, with the second half of the year seeing an unprecedented surge in corporate merger and acquisition (M&A) activity. This surge comes after M&A volumes dried up by more than 50% following the initial lockdowns in the spring of 2020, causing executives to re-evaluate opportunities, given the uncertainty[2].

Although total deal value is still down 6% to $3.5 trillion for 2020, more than two-thirds of the activity happened between July and December[3]. The fourth quarter of 2020 alone saw a 39% year over year increase in announced M&A deals from 2019[3]. Further, December was the fourth strongest month in history for M&A revenue. It is not just a high volume of small transactions; mega deal announcements have been all over the news. Such examples include the S&P Global acquisition of IHS Markit for $39 billion, the Salesforce acquisition of Slack for $27 billion, and AON's acquisition of Willis Towers Watson for $30 billion.

So, how is 2021 looking, compared to the second half of 2020? It appears unlikely to be any different. As management teams begin reflecting on what a post-COVID future looks like, we expect that companies will reposition themselves to adjust to shifting consumer behaviour, created by COVID. A quarterly survey of global CEO confidence reached a high of 64 in Q3 2020, after bottoming to 36 at the beginning of the year (like with Purchasing Managers' Index (PMI), ratings above 50 are positive and below are negative)[4]. That same report highlighted that of the CEOs surveyed, 36% plan to increase their capital spending over the next 12 months, compared to their previous expectations. Given the recent political changes in the US, it appears likely that the next CEO confidence survey will show even more optimism.

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[1] Divorces and Marriages Tumbled in U.S. During Covid, Study Shows, Bloomberg, January 5, 2021

[2] M&A Deals Comes Roaring Back as Executives Plot Post-Covid Future, December 24, 2020

[3] 4Q20 Independent Financial Advisor & Regional Broker Earnings Preview, Piper Sandler, January 13, 2021

[4] The Conference Board Measure of CEO Confidence™, October 20, 2020

Furthermore, many industries, such as travel, entertainment and energy, are still near their multi-year low; this makes companies attractive targets at their current valuation. While the initial expectation was that many names in these industries would go bankrupt, all-time low interest rates and massive liquidity injections made it so that they only had to load their balance sheet with more debts to stay afloat. These factors make it likely that the record high of $1.5 trillion cash that private equity funds currently hold will be put to work during the year. As opportunities become clearer, we will see a record year for M&A and other investment banking activities.

As for the important question on everyone's mind: how is Global Alpha getting exposure to this? We own Rothschild & Co (ROTH PA), among other names. Founded in 1838 by the famous Rothschild family, Rothschild & Co is one of the world's largest independent financial advisory groups, with headquarters in Paris, France. The company provides M&A, strategy and financing advice, as well as investment and wealth management. With 50 offices and 3,500 employees, the company has a foothold in over 40 countries, and it is still more than 60% family-owned. As a boutique firm, Rothschild also benefits from a favorable reputation in comparison to larger banks, as well as the trend of using more advisors to conduct individual deals. In 2019, boutique firms accounted for 22% of advisory deal value versus only 9% in 2000; its share is expected to keep increasing over the next decade.

Historically, the firm's activities centered on its global financial advisory and its wealth and asset management businesses. A little more than a decade ago, Rothschild added a new private equity business that now represents 8% of their revenue, but 17% of their profit share, representing a new growth driver for them. It is also the reason that Rothschild is able to maintain a better margin profile than its peers. Additionally, this allows the firm to deploy its own capital alongside their institutional clients and incorporate strong ESG principles in its investment decisions.

Within its global financial advisory business, Rothschild employs more than 1,100 advisors, and derives two-thirds of its revenue from pure M&A, with the balance from capital markets financing. Rothschild ranks sixth in revenue globally and first in Europe for its investment banking business. We are confident that the company will be able to benefit from the current environment.

SWOT

Strengths

- Leader in the European Union, consistently gaining market shares
- Best in class talent and solid reputation

Weakness

- M&A is highly cyclical
- High family ownership is a risk for shareholders

Opportunities

- US market share can double in size
- Emerging markets expansion

Threats

- Departure of key bankers
- Weak M&A cycle

Have a great weekend.

The Global Alpha team