Baker McKenzie.

The Automotive DealSCAPE

Executing Transactions in 2021

TRANSACTIONAL POWERHOUSE

Leading and closing complex deals – every day

Opportunity for Renewal & Reinvention

The new dealSCAPE

A bold vision of the future is redefining corporate strategy for automotives, with new opportunities arising from disruption. For many organizations, the fastest route to reinvention is through transactions — divesting to access liquidity, filling gaps in capability and organic growth, building digital revenue streams and adapting the scale and focus of operations to meet new market demand.

It is both more important and more difficult to execute business critical transactions now. The imperative to transform sustainably is in sharper focus, but routes to executing viable deals are less clear. Competition for attractive assets is high — especially in relation to emerging categories such as autonomous vehicles, e-mobility and connected cars — and companies are attempting lateral moves across non-traditional segments to access the technology, skills and assets they need. Distressed transactions and divestments are also set to rise, as automotives streamline and recover from the pandemic-related growth slowdown.

In this briefing, we explore the defining characteristics of automotive transactions in 2021 and introduce a framework to understand new legal complexity and stress-test plans in an evolving market.

Automotive DealSCAPE Trends

Strategy

Accelerate transformation

Automotives look to M&A to fuel post-pandemic growth and transition to next generation vehicles and digital revenue streams.

Competition

Adapt to a new market

Proliferation of new players and product categories presents a challenge to more established brands — raising the stakes for critical deals and partnerships.

Assets

Unlock expansion

As sought after digital assets become more expensive to acquire and COVID-19 creates short-term financial pressure, automotives must find new routes to access growth assets.

Process

Build deal momentum

Automotives are attempting to make rapid progress on digital transformation, but trade volatility, supply issues, pandemic-related shutdowns and travel restrictions mean longer deal timelines.

Environment, Social & Governance

Embrace longevity

Stakeholder scrutiny of ESG make sustainable product innovation and manufacturing key deal drivers for automotive organizations.

Automotive Market Factfile

- China recorded the best performance among the world's major automotive markets in 2020 and the Economist Intelligence Unit forecasts that China's total new-vehicle market will regain its 2019 levels this year — **crossing 27 million units in sales**.
- Japan's Manufacturing Purchasing Managers' Index rose from **49.8 in January to 50.6 in February**, marking a return to expansion for the country's manufacturing sector. This trend was also reflected in South Korea, where the PMI rose to **53.2** — its strongest improvement since 2011.
- **47% of dealmakers** in the Industrial, Manufacturing & Transportation industry predict an increase in M&A activity in Asia Pacific this year, according to Baker McKenzie research. 91% also predict an increase in distressed transactions specifically.
- **USD 45 billion** was invested in mobility startups in 2020, according to McKinsey.
- The New Energy Vehicle (NEV) market in China expanded by 10.9% year-on-year to **1.4 million units**, according to data from the China Association of Automobile Manufacturers.
- Analysts anticipate a brisk **8% year-on-year rise** in global light vehicle sales in 2021, with the industry on track to overtake 2019 levels by the end of 2023.

1 Strategy | Accelerate transformation

Trend	Opportunity	Legal considerations
Transition from internal combustion engine vehicles to e-mobility, new energy (NEV) and electric vehicles (EV) in support of ESG goals and shifting consumer preferences.	As the wider automotive industry pivots away from traditional revenue streams, developing NEV (New Energy Vehicle) and EV (Energy Vehicle) product lines and acquiring related suppliers represents an opportunity for established players to shore up long-term performance and meet ESG requirements.	Success of automotives, making thoughtful targeting, valuation and due diligence particularly important and underscoring the need to weigh deal synergies, value drivers and derailers upfront.
Imminent withdrawal of COVID-19 state aid and the challenge of regaining revenue growth in a low-demand market is likely to drive strategic reviews, reorganizations and distressed M&A in the automotive sector.	The pandemic has given rise to a sharper assessment of products and services, operations and assets. As markets recover from the economic fallout of COVID-19, automotives can reshape and streamline in order to adapt. Filling growth gaps arising from disruption and uncertainty is also a strategic priority for organizations large and small.	To support growth and integrate new strategic acquisitions into a high-functioning portfolio, leaders may need to consider restructuring and divestment to fund pivotal transactions, streamline operations and address underperformance. At the same time, many companies will find there may be opportunities to acquire the assets and grow their business in the markets that are being divested and exited by their industry peers.
Investment in CASE technology to build new revenue streams and access key skills including advanced coding.	Investment in CASE technologies and intellectual property, data and digital talent acquisition likely to drive M&A activity in the automotive sector. And, as companies rethink how they can serve customers with online sales platforms, contactless payment solutions and last-mile delivery, deals that can further facilitate sales and support new ways of living are likely to rise.	Automotive companies should prioritize a strategic review of corporate plans, operations and pipeline deals to ensure transactions will support business strategy, and conduct a market assessment to identify attractive opportunistic deals arising from pandemic-related distress in the industry.

2 Competition | Adapt to a new market

Trend	Opportunity	Legal considerations
Proliferation of new players and competitors, especially in the EV market, presents a challenge to more established brands.	Traditional players may find that the legacy operations and networks they have built up over decades need to be shed and replaced to meet the requirements of new technologies and distribution channels, and to compete with more agile market entrants.	Examining supply chains, distribution networks, operations and assets through the lens of future growth is key for automotives. Consider where to divest to free up capital and the structures and partnerships needed to compete in high growth segments.
As new players enter the market, overcrowding could force competitors to consolidate.	Adapting to new consumer preferences, sustainability standards and digital business models is expensive. Automotive organizations are targeting economies of scale — joining forces to scale up transformation and strengthen the balance sheet post-COVID-19. We are likely to see a similar trend in relation to next generation vehicles, as the NEV market develops.	Scrutiny from competition agencies is likely to arise from landmark deals and mega-mergers. As the automotive industry reshapes, anticipating merger control and foreign direct investment issues will become more important.
Significant competition for in-demand CASE capabilities and assets.	The technology assets required by automotive players are scarce and in-demand, increasing competition among dealmakers. But there is a strong and growing ecosystem of startups developing CASE tools and systems. Innovation in the sector creates opportunities for valuable alliances between new entrants and traditional OEMs.	Early-stage minority investments and collaborative deal structures may enable traditional automotive companies to access the capabilities they require. Where ownership is key to competitive advantage, automotives should use their scale and legacy infrastructure to make bids more attractive — emphasizing the ability to operationalize solutions to provide a clear route to revenue for targets.

3 Assets | Unlock expansion

Trend	Opportunity	Legal considerations
While many larger, more established brands may seek to divest assets, others will seek to acquire them to accelerate their entry into new markets and plug gaps in organic growth.	While established brands that have developed a global footprint of manufacturing and distribution assets for traditional vehicles will be seeking to divest assets and exit markets that are slow to develop the new vehicle technologies they are focused on, at the same time, less developed brands looking to grow their global presence and enter new markets. In particular, Chinese automotive brands will be looking to acquire those assets and fill the market niches left by the exit of the traditional players.	When considering distressed assets, acquirers should pay attention to the resilience of the target and the financial performance and credit solvency of their entire supply chain. Non-traditional deal structures, such as deferred consideration, loan-to-own and options-based arrangements, can also be used to de-risk transactions involving distressed businesses.
Influx of private capital is driving up prices, making acquiring acquisition-ready assets more risky and expensive.	Acquirers pursuing digital transformation could be in unfamiliar territory on regulation and compliance — targeting non-traditional assets in adjacent industries and new markets. Desirable assets are likely to be development-stage technology companies looking for fast capital to fund development and scale operations. But valuing non-traditional assets is problematic, and the struggle to align parties on price is leading more investors to pursue minority investments.	Minority investment is not without risk — particularly in relation to IP rights. Investors must ensure they have the appropriate rights to protect their investment throughout the lifecycle and control the exit process. This is critical in relation to consortium-backed development, where the process of gaining individual approval from third parties and transferring shared ownership to acquirers is time-consuming and complicated — especially in China.
As the sophistication and connectivity of automotive products grows, cybersecurity has become a high profile concern.	Narrow guidelines exist for specific technical procedures to secure hardware and software in vehicles, such as standards for hardware encryption or secure communication among ECUs (Electronic Control Units). But the World Forum for Harmonization of Vehicle Regulations is planning to release new regulations on cybersecurity and over-the-air software updates. This is likely to spark new innovation in the evolution of bespoke solutions for NEVs, autonomous and connected vehicles.	As vehicles increasingly come to be known as "computers on wheels", automotives would be wise to step up efforts to develop the hardware and software required to protect customers and their data. This imperative is likely to drive new deal activity as well as in-house development — especially given the lack of advanced coding talent currently within established players.

4 Process | Build deal momentum

Trend	Opportunity	Legal considerations
Investors and shareholders are urging automotives to take urgent action on digital transformation in response to consumer demand and new technology. But trade volatility and the ongoing shockwaves of pandemic-related restrictions mean longer timelines on transformative deals.	Organizations need to find ways to build relationships, conduct negotiations, perform due diligence, close deals and integrate new acquisitions in a remote environment. Digital processes are the enablers of dealmaking as well as drivers of transactional activity.	Digital tools can accelerate key M&A processes for automotive organizations even after travel restrictions are lifted – particularly in relation to due diligence and merger control, such as **GMAP** from Baker McKenzie.
Rise of sanctions and investment and trade restrictions present obstacles to outbound growth, while China eases restrictions on inbound investment in the automotive sector.	Transactions between Asia Pacific and North America are increasingly challenging as a result of regulatory protectionism and ongoing uncertainty regarding US-China relations. However, European automotives are capitalizing on the region's growing markets to expand their interests — particularly in relation to electric vehicles.	Navigating FDI (Foreign Direct Investment) restrictions and the changing picture of regulation and government support to the automotive sector is critical to setting successful deal strategy. For example, how the end of NEV subsidies in China in 2022 will impact consumer demand.
COVID-19-linked supply chain disruption and a crunch in semiconductor production threatens recovery.	A significant shortage in the chip components that underpin infotainment systems, power steering and assisted braking in vehicles is expected to limit automotive production in 2021 and beyond. This is indicative of a broader trend of supply chain vulnerability highlighted by the pandemic, which organizations now have an opportunity to address.	To strengthen supply chains and ensure these networks are able to meet new needs, automotives should reexamine their requirements and risks. Transactional activity will be driven by nearshoring, in-sourcing fixed assets and divestments, and we expect a rise in the application of digital tools such as automation and blockchain to manage supply in real-time.

5 Environment, Social & Governance | Embrace longevity

Trend	Opportunity	Legal considerations
Investor and shareholder scrutiny of ESG is raising questions over the sustainability of current practices and assets.	Automotives have taken steps over the past decade to build new sustainable practices, reduce emissions and pivot to next generation mobility solutions. However, there is also a need to critically review and divest unsustainable or non-core assets.	Failure to provide ESG credentials is perceived as an investment liability. Therefore, in addition to standard due diligence, sellers looking to divest should expect to provide a broader review of ESG risk that encompasses supply chain practices. Where material ESG risk has been identified, buyers should consider seeking contractual protection in the acquisition agreement. We also expect to see greater focus on ESG performance goals and vesting conditions as part of negotiations.
Proliferation of NEV, EV and e-mobility tie long-term. growth to sustainability.	ESG is front of mind for financial and strategic investors in the automotive sector, where embracing more sustainable forms of mobility, circular manufacturing and raising ESG standards can provide a valuable edge in the fight for capital.	To comply with legislative requirements on ESG while ensuring cost-effective manufacturing requires an examination of both products and processes. This imperative towards longevity will drive deal activity — particularly in integrating alternative fuels, battery technology, biodegradable components and the Internet of Things (IoT).
Conflict between buyers and sellers on ESG commitments holds the potential to collapse deals.	Progress on ESG remains patchy across APAC markets and the scope of sustainability varies — with some organizations led by local regulatory minimum standards and others choosing to set bolder targets according to company values and global best practices.	Aligning buyers and sellers with different attitudes towards and priorities for ESG can bring deals to a standstill — especially on complex cross-border deals. These issues must therefore become a higher priority in targeting, valuation, due diligence and within overall deal negotiation.

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