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Corporate M&A 2023

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Cayman Islands: Trends & Developments

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Trends and Developments

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Mourant

Mourant is a law firm-led, professional services business with over 60 years' experience in the financial services sector. It advises on the laws of the British Virgin Islands, the Cayman Islands, Guernsey and Jersey, and provides specialist entity management, governance, regulatory and consulting services. The firm bridges the gap between legal advice and its implementation, taking an integrated approach to deliver the best results for clients.

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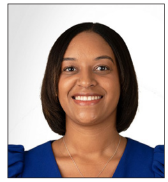

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M&A in the Cayman Islands: an Overview

Overall deal volume and value were lower in 2022 compared to the record-breaking year of 2021, but global M&A markets across regions and sectors saw higher activity than pre-pandemic levels both in the number of deals announced and in publicly disclosed deal values. Many sources reported nearly USD3 trillion in M&A deal value globally.

Due to its position as the offshore jurisdiction of choice for establishing private equity fund structures and the global popularity of the organisational forms it offers, the Cayman Islands retained its position as a pre-eminent jurisdiction for M&A transactions during 2022. The Cayman Islands has continued to see M&A and related activity in a wide variety of transaction types and forms.

Cross-border M&A

The vast majority of M&A taking place in the Cayman Islands is cross-border due in part to the popularity and familiarity of use, particularly to the US market, of Cayman Islands exempted companies and exempted limited partnerships.

In line with global trends, the Cayman Islands saw a slowdown in deal volume and value in cross-border M&A transactions during 2022, with the uncertainties in the global economy and the corresponding business and investor dip in confidence impacting deal activity. Previously strong sectors such as SPAC/de-SPAC were also impacted, as discussed below.

Nonetheless, although not as busy as in previous years, the Cayman Islands did continue to enjoy a significant amount of cross-border M&A, with traditional strategic acquisitions and general consolidation transactions with a Cayman Islands element continuing in 2022. Growth was seen in private equity take-private activity compared to 2021 (USD245 billion by value in 2022 compared to 2021's record high of USD239 billion), although private equity-driven downstream M&A transactions fell in 2022 compared to 2021.

SPACs

A SPAC transaction is described in general terms as an IPO for a private equity investment that is still to be determined. These special purpose acquisition companies (hence, SPACs) are commonly known as "blank cheque" companies because investors commit money to an unidentified future investment.

Once the SPAC IPO is completed, the proceeds are held on trust until a suitable investment opportunity is identified, at which point the funds are deployed by way of a business combination or "de-SPAC". Investors have the right to vote to approve the business combination, or they can redeem their investment instead. If no such opportunity is found within a specified timeframe, proceeds are returned to investors. The Cayman Islands exempted company is a vehicle of choice for the SPAC because of the simplicity and flexibility of the jurisdiction's companies legislation and its familiarity to stock exchanges.

The use of SPACs by US managers initially ignited in 2020, with 248 SPAC IPOs taking place on the New York Stock Exchange and NASDAQ in that year, which strongly continued into the first quarter of 2021. Increased SEC scrutiny paused that trajectory, but despite this setback the volume and value of SPAC IPOs in 2021 surpassed that of 2020, reaching 612 SPAC IPOs, with proceeds of USD156.7 billion in 2021 compared to USD83 billion in 2020.

This SPAC IPO trend now seems to have taken a downturn. Various factors have curtailed investors' appetite for these vehicles, such as high interest rates, general macroeconomic uncertainty and the poor performance of recently de-SPACed companies, together with regulator interest and litigation. This is borne out in the figures: 2022 saw just 83 SPAC IPOs with an associated value of USD13 billion. This downward trend seems likely to continue into 2023 and beyond.

De-SPACs

The tail end of the SPAC life cycle is when the manager has identified an investment opportunity, seeks investor consent to the business combination and consequently "de-SPACs". Typically, a manager has 18 to 24 months in which to find a target for the SPAC. Therefore, due to the boom in volume of SPACs coming to market in 2020 and early 2021, a high proportion of SPAC vehicles were looking for de-SPAC opportunities during 2022.

However, the slowdown in investor interest in SPAC IPOs is mirrored in a slowdown in activity in de-SPAC transactions, with 119 de-SPAC transactions completed in 2022 compared to 197 in 2021. In addition, a number of de-SPAC transactions that were announced in 2022 failed to complete, and redemption rates – which were around an average of 61% at the end of 2021 – rose to an average redemption rate above 81% in 2022.

Given the number of SPACs continuing to look for de-SPAC opportunities as their investment period ends and ongoing challenges in the global economic climate, as well as regulatory challenges for SPACs specifically, it seems likely that the high redemption rates and termination rates of transactions will continue.

Co-investment platforms and joint ventures

With global M&A markets uncertain during 2022, the need for strategic and creative deal structuring solutions continued. Cross-border co-investment platforms and joint ventures involving Cayman Islands vehicles continued to see use during 2022, albeit at lower levels than in 2021. These investment structures allow companies and investors to pool capital and combine market expertise, which furthers innovative collaboration among deal makers and allows for expansion into diverse sectors, with ultimately less financial risk for each participant.

During 2022, these investment platforms continued to see use in asset classes such as financial services, technology, industrials and real estate. M&A activity through co-investment platforms and joint ventures has continued to be in demand in the Cayman Islands so far in 2023 as deal makers continue to look to combine expertise and resources to structure M&A transactions.

Private equity secondary transactions

Private equity secondary, or continuation, transactions continue to grow apace. In this market, investors trade stakes in existing (or primary) private equity funds and assets. The sector covers a variety of deal structures, including:

- investor-led trades of LP interests to manage liquidity (for outgoing LPs) or acquire access to a fund that was oversubscribed during the initial fundraise (for incoming LPs); and
- GP-led single asset continuation funds that are designed to enable general partners to transfer a high-performing investment into that continuation fund, and so hold it for longer.

This latter variety of secondary transaction, in particular, has increased over the last year, due in part to the maturity of the private equity sector and primary funds. The global economic climate has also contributed to popularity in this sector, as the general market uncertainty has led to managers being reluctant to divest of high-performing assets as the expiry of the primary fund's term approaches, and to investors having an appetite for those managers and assets with a known, strong performance history in preference to a new primary fund. This sector looks likely to continue to increase throughout 2023.

Divestitures

In 2022's environment of market uncertainty, companies turned to divestitures of non-core or under-performing business and product lines to raise cash and optimise corporate portfolios, allowing companies to focus on their core business. These divestitures are especially attractive to purchasers with similar business and product lines that can pair their existing assets and expertise with the newly acquired divested assets to unlock corporate synergies.

A central element in preparing for divestitures is carving out the divested business – ie, separating the business operationally and financially from its parent company. 2022 saw activity related to existing Cayman Islands subsidiaries being sold out of group structures by way of share sales. There was also activity related to non-core assets and under-performing businesses and product lines carved out of existing operational entities and transferred to newly incorporated Cayman Islands vehicles to accomplish divestitures.

Local M&A

Although the vast majority of the Cayman Islands' M&A activity is in the offshore international market, there has also been some action in the domestic market. A long-running local trend has been consolidation in the Cayman Islands' corporate services, trust and fiduciary services industry, which is a sector that contributes hugely to the local economy. This trend continued in 2022, with various international companies acquiring local businesses as an introduction to, or a further expansion into, this domestically strong sector.

ESG

In line with global trends, the Cayman Islands' financial services industry (both public bodies and private firms) continues to develop the jurisdiction's role in promoting responsible ESG principles. The Cayman Islands government has announced that it is working on a legislative framework for the implementation of ESG criteria for the Cayman Islands' financial services industry, and the Cayman Islands Monetary Authority has announced that, in line with other regulators around the globe, it is reviewing and monitoring this emerging trend with a view to developing a suitable supervisory approach to ESG-related risks.

Outlook

There are challenges on the horizon, such as market volatility, higher interest rates, the prospect of a recession and increased regulation. The continuing conflict in Ukraine, the resulting sanctions that have been imposed and other strained international relations add further uncertainty to the M&A market. Nonetheless, transactions – including significant deals that would bring fundamental change to a business – remain a possibility during this period of market uncertainty. Valuations may become more attractive to purchasers, and there may be fewer players opting for the same target because of the market risks. There continues to be an abundance of available capital and pent-up demand for deal making, which may keep driving deal flow in the M&A market and the Cayman Islands during 2023.

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