DuPont Capital

EQUITY STRATEGY REVIEW
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## Merger Arbitrage

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After grinding to a halt in Q2, the M&A market started to show some signs of life during Q3. Several multibillion-dollar public deals were announced, including three notable tie-ups between large cap pharma and biotech. This is a continuation of a trend that has persisted for several years in biotech, as the pharma companies tend to have good balance sheets and can offer substantial cash deal premiums to biotech targets. In the quarter, key deals included Immunomedics/Gilead ($20 bil), Momenta/Johnson & Johnson ($6 bil), and Principia Biopharma/Sanofi ($3 bil). Beyond biotech, there were a few other sizeable transactions including Noble/Chevron, Maxim/Analog Devices, and Livongo/Teladoc. Each deal was primarily a stock deal, which underscores the attractiveness of stock as an acquisition currency during elevated equity market conditions.

From a merger arbitrage perspective, the increase in the number of deals provides a wider opportunity set, but in most cases, the spreads remain too tight to put on full positions. Most biotech deals are structured as tenders, which close in 45 days, so the gross spread is typically quite narrow. Given the large premium, downside can be quite significant. Usually, these types of deals close without any issues, although in recent years, there have been notable stumbling blocks such as the Roche acquisition of Spark Therapeutics. That deal ultimately closed, but not before encountering a lengthy regulatory review regarding product and pipeline overlap. During the life of the deal, the spread was quite volatile and widened substantially before closing.

As the US presidential election nears, regulatory risks for M&A deals continue. US/China relations seem to reach a new low almost daily and the concern is that regulatory reviews of multinational deals will become a geopolitical weapon. Even in the best of times, the CFIUS and SAMR review processes were opaque. Now, confidence in approval, particularly for SAMR remains a significant hurdle with little ability to gain comfort around the process. In certain deals needing SAMR approval, we often find that the spread does not price in enough reward for the risk of a lengthy process that could result in rejection.

In the last quarterly, we discussed that many buyers are testing the validity of their merger agreements and asserting a breach of operating covenants or occurrence of a material adverse event (MAE) in order to abandon the deal. During Q3, Tiffany/LVMH was added to the growing list of deals that have resulted in litigation. As mentioned previously, the occurrence of an MAE has only happened once in Delaware court history. Given the high bar for finding an MAE, most litigation often results in a settlement. In the quarter, Forescout Technologies and Advent set aside their differences and agreed to a 13% price cut to original deal terms, which was far less than the market was expecting. Several notable deals such as Taubman/Simon Property and Tiffany/LVMH remain in the court system and we eagerly await the outcome. Both deals already trade at a large discount to the original price and a settlement in line with past broken deals could lead to a price rally. We believe in both cases that the sellers have very strong contractual legal protections.

In Q4, there may be a pause in M&A as buyers wait to see the outcome of the election. Regardless, many buyers have good balance sheets and credit markets are very accommodating for financing. The conditions that led to a resumption in activity in Q3 should continue post-election.

## About our firm:

DuPont Capital Management is an SEC registered investment advisor based in Wilmington, Delaware. Since the firm's establishment in 1993, we've had a long history of developing global investment opportunities in both traditional and alternative strategies across equity, fixed income and alternative investments. Our investment team structure gives us the ability to be flexible and adapt to changing market conditions. DuPont Capital's focus is delivering consistent investment management results for our clients. Our history of institutional asset management is rooted back to 1942 when our former parent company, DuPont, established a pension plan for its employees. Corteva Inc. succeeded DuPont as sponsor of the DuPont Pension Plan in 2019. DuPont Capital is a wholly owned subsidiary of Corteva and continues to manage the legacy DuPont Pension Plan.

DuPont Capital's President and CEO, Valerie Sill believes in education and diversity of experience as represented in our investment teams which are comprised of PhDs, engineers, medical doctors, and scientists. We believe their global expertise creates a portfolio implementation edge that benefits our clients.

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### Important Disclosures: