

ALLEN & OVERY

The pendulum swings

M&A Insights | H1 2017

Data provided by



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The pendulum swings

M&A activity continues to hold up surprisingly well in an uncertain world. Interestingly, growth has swung markedly towards Western Europe, whilst dealmaking in Asia and the usually dominant U.S. has slowed.

01 Western Europe market rebounds strongly

Transaction values in Western Europe rebounded strongly in H1, lifting M&A activity in the region to its highest level for nine years at USD412 billion. A 45% uplift in deal values came despite a 19% decline in deal volumes, indicating that big strategic deals still dominate.

We saw a particularly strong surge in cross-border deals within Western Europe, where transaction values have climbed by 130% this year compared with H1 of 2016. Western Europe has once more overtaken the Asia Pacific market in terms of deal values, having fallen behind for the first time in 2015.

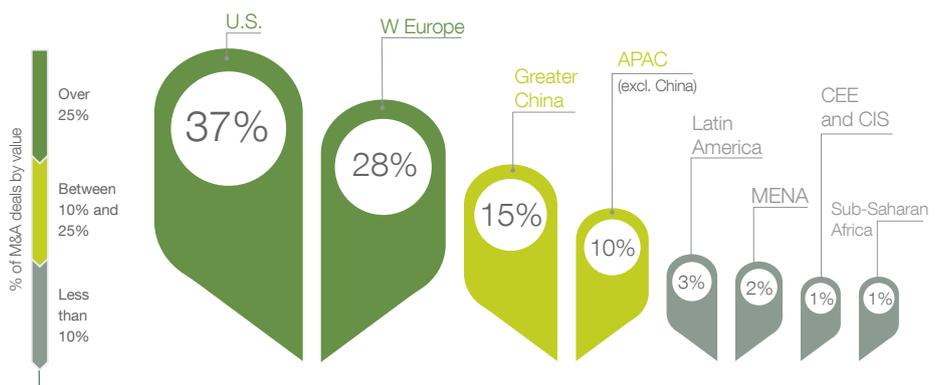
Perhaps most surprising was the strong performance of the UK market, with inbound deal value up by 86% and outbound up by 217% – a nine-year high. Dealmakers appear to have been comforted by the set timeline for the UK leaving the EU and positive UK economic data which, together with continuing access to cheap debt and quality assets, has given the UK M&A market a boost, albeit in the short-term.

Investors in continental Europe also seem relatively relaxed about the political uncertainties that still abound. Most seem to have priced Brexit into their transaction strategies, despite initial nervousness, and election results in France and the Netherlands appear to have further calmed nerves, although sentiment could be tested again in the autumn when Germany goes to the polls. Despite that, we expect M&A in Western Europe to continue to grow in the second half of the year.

Cross-border M&A within Western Europe

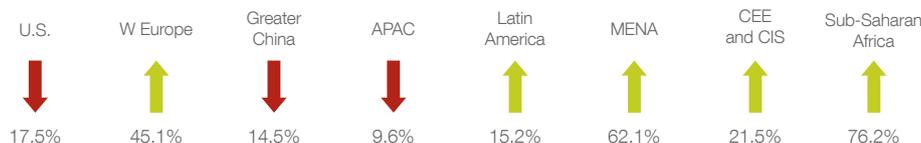


02 Changing patterns of growth – H1 deal value by region



After a very strong opening quarter, U.S. growth slowed whilst Western Europe picked up the pace. U.S. deal values for the H1 period fell by 18%, although volumes grew by 16%. Activity continued to slow across Asia with deal values falling by just over 10% and volumes by 5%, although intra-regional activity remains quite robust with deal value up 41%. The continuing slowdown in Greater China reflects increased governmental scrutiny of outbound deals. India stood out in the region with deal values almost doubling, albeit from a relatively low base.

% change from H1 2016



Note: These figures represent deals announced between 1 January 2017 and 20 June 2017.

Data provided by



03 Private equity funds busier but still wary of overpaying

Private equity transactions have increased strongly in the first half of the year, with the value of leveraged buyouts at a four-year high and secondary buyouts up 119% on last year's level. In addition, we are seeing sizeable disposals of PE portfolio businesses to trade buyers, including EQT's EUR3bn sale of financial information group Bureau van Dijk to Moody's and NPM Capital's sale of Vanderlande to Toyota for EUR1.2bn.

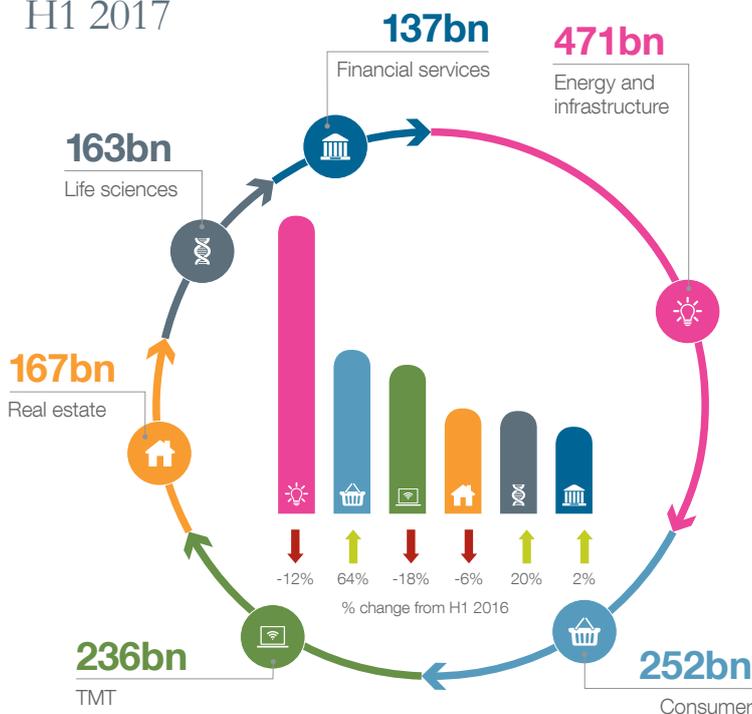
The uptick in private equity deals comes after a hiatus when many PE houses were focused on raising new funds, often at record levels. Permira, Advent, Apax and Cinven are among those to have

successfully raised new funds, while CVC recently set a European record with its new EUR16bn fund.

The dilemma is how to deploy these funds in an increasingly competitive market without being forced to pay peak prices, thus preventing the delivery of promised returns to investors. Increasingly, we think the accent will be on finding "buy and build" platforms, primary buy-outs of companies with plenty of scope for efficiency savings and leveraging sector or operational expertise.

04 Consumer deals remain surprisingly resilient

H1 2017



Given continuing macro-economic and political uncertainty, it's a surprise to see consumer deals powering ahead for the second quarter in a row, susceptible as they are to wavering consumer confidence. Deal values were up by 64% in H1 on the same period last year.

The potentially game-changing deal of Q2 was Amazon's proposed acquisition of Whole Foods. Combining Amazon's e-commerce expertise with Whole Foods' bricks and mortar operation could bring a step-change in both online and convenience grocery. Certain other possible corporate combinations may now be more likely as competitors digest the effect that the Amazon/Whole Foods group will have, and work out how best to react to it.

The decision by China's Bright Food Group to sell the Weetabix brand to Post Holdings of the U.S. for USD1.4bn is, we think, indicative of a wider trend – the difficulty Chinese companies are having in rolling out western brands at home. Inbound investors into China are thinking along similar lines, now often opting to buy established Chinese brands rather than importing their own into the market.

05 Protectionism? Don't rely on it for your bid defence

High profile takeover attempts, including PPG/Akzo Nobel and Kraft Heinz/Unilever, have continued to stir rhetoric in some jurisdictions, including the Netherlands and the UK, about protecting "crown jewel" national assets. But, while the protectionist rhetoric has increased in volume, it is doubtful that political intervention is playing a significant role in preventing deals from taking place outside designated sectors where governments have clear powers to block bids (in the UK, for instance, to protect defence assets or safeguard media plurality).

It can undoubtedly pay huge dividends for both acquiring and target boards to win political backing for their cause, as part of a broad effort

to win stakeholder support. But we are not seeing protectionism, or recourse to government, as a frontline bid defence tactic. Ultimately, a target board's fiduciary duty to turn down approaches if they fail to represent good shareholder value remains the key determining factor. A bid defence strategy based around value and the merits of the target's business is more compelling than leaning on third party factors.

One clear exception is the U.S. where the CFIUS foreign investment committee, which vets bids for U.S. companies or businesses with a U.S. interest, has far-reaching and extra-territorial powers to intervene, and these continue to be deployed with vigour.

Fintech: the best way to deal with disruption? Embrace it!

Fintech companies, both early stage and more mature, are continuing to attract investment from a wide range of sources including the financial institutions they were set up to disrupt. What does this tell us about future M&A trends in this sector?

A flood of new investment has poured into the fintech sector since 2010, with some estimates putting total investment in the six years to 2016 at over USD130bn.

While activity has levelled off this year, the market is still healthy. A significant proportion of this investment comes from established financial services players who have stepped up their interest in fintechs, and particularly in those focusing on B2B solutions and banking services. Some are beginning to ask if we are on the brink of a much more substantial wave of investment or consolidation in the years ahead.

Investment by established players takes a range of forms, from outright acquisition to taking minority stakes in emerging companies, either alone or with others.

Several of the major players have set up corporate venture arms to invest in promising targets, while others have established accelerators or incubators either independently or in partnership with existing investors, capitalising on the latter's sophistication in early stages investment.

There is evidence in Asia and Europe of some institutions choosing to work together through club deals, while some banks are trying to become fintech operators in their own right by white-labelling back office processes in conjunction with small tech start-ups. One example comes from French bank Crédit Mutuel Arkéa, which recently launched a bank account aggregator built on technology from both the fintechs in which it has invested and its own in-house solutions.

The particular subsector of the fintech market will often dictate the nature of the M&A, investment or collaboration chosen. For example, more established technologies such as payment services are rapidly becoming the subject of full-blown M&A, driven by typical M&A motivations – expansion into adjacent industries, gaining access to upgraded compliance, back-office and IT structures and consolidation plays to build scale.

For less developed, nascent technologies, such as blockchain, however, most activity is taking place at the early investment stage. At this level, investments are being made well before a company has established a track record of financial performance – investors are buying into a business plan and/or potential future economies of scale, rather than current results.

But the hope is that these small and, often, quite speculative investments in new technologies might eventually help institutions to meet consumer demand for new delivery mechanisms they cannot provide on their own or help them to tackle back office inefficiencies, where their own legacy technology systems have held them back for many years.

Drivers of growth

The fear of disruption or being rendered obsolete by fintech challengers is a major motivation for investment. Incumbent players are buying in capability – investing in IP, IT systems, distribution and talented people. They recognise that to do so is the best way to shorten or even bypass the R&D cycle and create greater agility and innovation in their organisations.

Banks, for instance, know that their customers are demanding a “digital first” approach and that legacy IT is often not up to the task. M&A in this context is about the speed with which you can get a new idea or service to market.

The threat of competition from other sectors is also a real one.

Technology and internet companies clearly see the financial services market as fertile ground for diversification and are becoming increasingly active. Facebook, Google, Naspers, Apple, Alibaba and Samsung are among the many that have made forays into the payments market in recent years.

Areas like lending and wealth management are seeing similar interest, with Google investing in the savings app, Digit, for example. However, there remains a question mark as to whether tech and internet companies will be ready to make the necessary investment in structural costs linked to back office and compliance.

There are players, however, in other sectors looking to muscle in too. The parking payment service PayByPhone was recently bought from PayPoint for GBP26.5 million, not by a bank but by VW, albeit through the carmaker's financial services arm.

“The fear of disruption or being rendered obsolete by fintech challengers is a major motivation for investment.”

Jean-Claude Rivalland
Partner, Paris

Fintech M&A is unfamiliar ground for all stakeholders

When established players and fintechs come together they can find themselves in unfamiliar territory, and, despite the need to move at speed to win the quickening race for prized assets, buyers and sellers need to exercise caution.

For sellers, the obvious approach in the early stages of development is to adopt a low-cost model, but in our experience that can have a significant negative impact on the ultimate value of the business.

Leanly financed start-ups may not prioritise legal and regulatory advice, but in a highly sophisticated and regulated environment like financial services this can have a significant impact down the road. We've seen a number of examples where early stage companies have failed to secure the necessary regulatory approvals and licences. Securing these later can take considerable time and interrupt or delay a deal being completed, during which time competing technologies may have forged ahead or the start-up may have run out of money.

There are dangers for buyers too. Big banks – even the most active in the transactions market – may have little or no experience of making small investments.

The task of putting a value on an unproven technology is always fraught with difficulty and, with competition for assets intensifying, there can be a tendency for investors to piggyback on each other's valuations, exerting an inevitable upward pressure on prices.

A buyer's legal team will also need to develop a pretty sophisticated understanding of the technology involved to make the right calls on structuring a deal and drawing up an appropriate and robust warranty package.

Stretched in-house legal teams may not have time to really get among the weeds – to understand, for instance, whether the IP behind a technology is exclusively held by the target or reliant on open-source technologies.

Looking ahead

As the fintech sector becomes increasingly busy, we believe established financial services groups will be centre-stage in this process as they try to capitalise on the trust they have established with their existing customers while innovating to meet their changing demands.

There remains a question mark over how many fintech start-ups will grow into fully-fledged independent businesses and how many will ultimately partner with the banks they were set up to disrupt.

But given the range of innovation in the fintech sector and the diversity of potential competitors, it is likely established institutions will continue to have to work hard to keep up with the pace of change.



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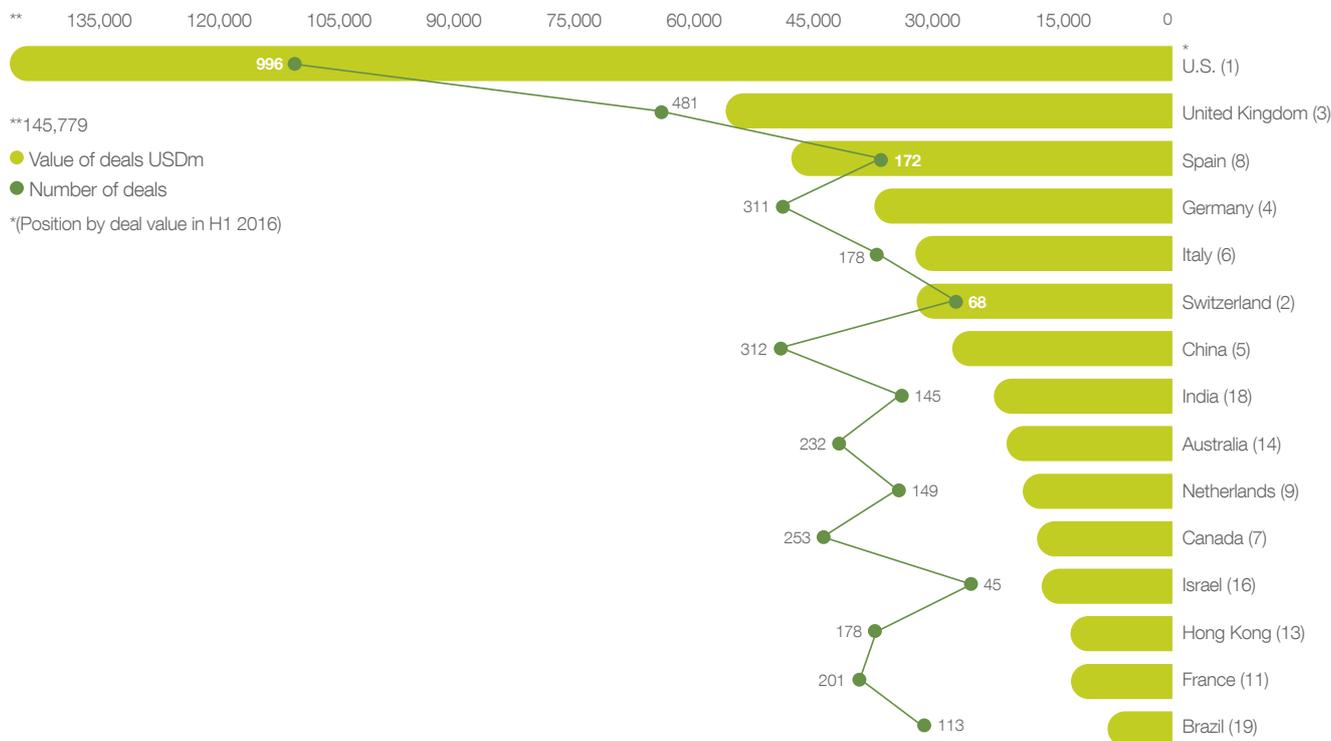
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Global deal flows

Inbound target markets



01 Spain's biggest companies in the frame

The performance of Spain's M&A market is often driven by activity around its biggest and most global companies, notably in the infrastructure, energy and financial services sectors.

But H1 of 2017 has seen a much higher than average level of activity, propelling Spain to third place in the league of cross-border target markets, globally. Much of that is driven by big proposed deals, notably the planned takeover of highway operator, Abertis, by Italy's Atlantia in a EUR16.3bn deal and the EUR2.6bn acquisition of Naturgas Energía Distribución gas distribution network by an investment consortium.

Domestically, Santander's eleventh-hour rescue of Banco Popular is a smaller deal but potentially with huge impact on Spain's banking sector and the EU's bank rescue regime.

It remains unclear what attitude the government will take to the Abertis deal and what powers it has to influence the outcome. The position of Abertis' biggest shareholder, (Criteria Caixa), with a 22% holding, will also be crucial.

But the uptick in activity underlines the growing competition for high quality infrastructure and energy assets, the continuing availability of cheap debt, and a degree of regulatory certainty that has come with a calmer political environment in Spain, which we expect to continue.

02 Telecoms and e-commerce consolidation grips India

The first half of the year has seen robust levels of M&A activity in the Indian market, with deal values climbing by a massive 89%, driven in part by a small number of mega deals.

Inbound investment continues apace in key sectors, including telecoms, e-commerce, banking and insurance. This reflects investors' current confidence that the political stability created since the election of Narendra Modi's majority Government is now well established and likely to continue beyond the next national elections in 2019, as well as confidence in the broader investment environment.

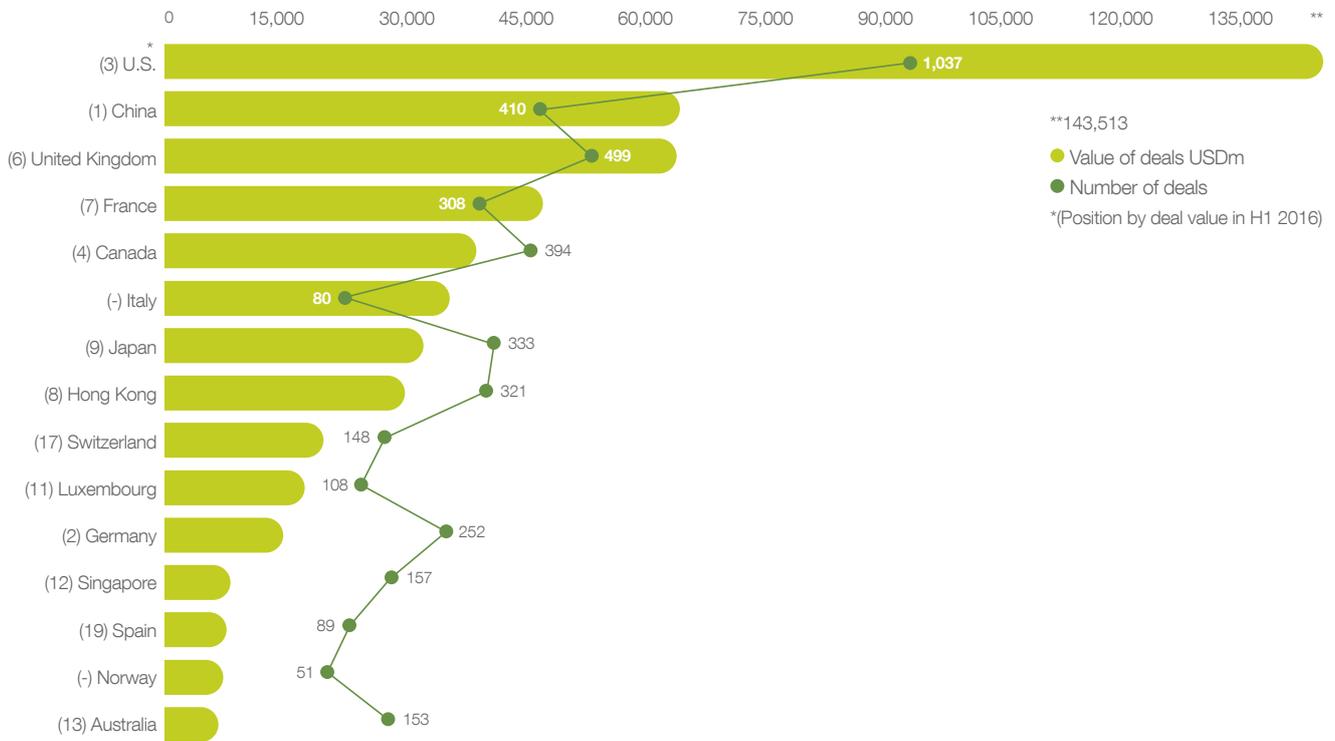
Two sectors in particular have attracted M&A activity: telecoms and e-commerce. The launch of the Rio 4G service has shaken up the mobile market. Huge investment and the offer of free calls has seen Rio amass 100m subscribers since its launch last September. Competitors have responded by consolidating, for example we have seen Bharti Airtel acquire Telenor's Indian operations, while Vodafone and Idea Cellular are now merging in a USD23bn deal.

In e-commerce, the market is waiting to see if Softbank will proceed with the merger of Snapdeal and Flipkart, bringing two of the biggest players in online retailing together. Transaction levels were most buoyant in Q1, with a slight slow down in Q2. Some investors appear to have held off on doing deals in recent weeks pending the government's move to replace a host of regional sales tax regimes with one national Goods and Services Tax. It remains to be seen how this major, and long-debated, reform will play out in the coming weeks.

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Outbound acquirers



03 “National strategic importance” debate returns to Dutch market

Growing activity by overseas investors, particularly from the U.S. and Asia, has driven Dutch M&A in the first half of the year. Standout deals included the USD7.2bn Thermo Fisher bid for clinical trial drugmaker Patheon, plus a raft of sizeable PE deals including KKR’s EUR2bn acquisition of car-parking group Q-Park.

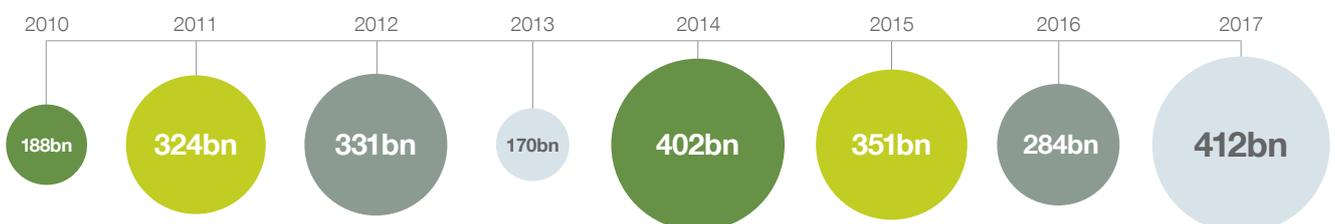
But with some of the country’s most prestigious companies in the frame, that has inevitably re-ignited debate about protecting “crown jewel” assets from takeover and whether there needs to be protection for companies in sectors that are of national strategic importance. However, it is unclear whether Unilever (approached by Kraft Heinz in a GBP115bn proposed deal) and Akzo Nobel (which rejected a EUR26.9bn offer from PPG Industries of the U.S.) would fall into this category.

04 Eyes on Luxembourg

Luxembourg-registered companies continue to be highly active across borders, both in the U.S and in Europe, as we saw with the USD7.2bn Panera Bread acquisition by JAB Holdings. Chinese banks also continue to build their presence, underlining their confidence that Chinese outbound investors still have their sights firmly set on Western Europe.

While initial investor fears about Brexit have diminished in the context of M&A, financial institutions, particularly asset managers, are busily trying to establish a Luxembourg base to preserve their EU passporting rights.

Western Europe H1 deal value (USD)



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