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for future growth

M&A Index, Q1 2014

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Executive summary

The global picture – our key observations

A number of key themes emerge from the statistics and analysis contained in this report. Having reviewed deals in each region and sector worth more than USD100 million, here are our observations about the state of the global M&A market in Q1 2014 and likely future trends.

Markets across the world continue to be at different stages of recovery, but, in general, we sense activity is once again beginning to build, even if it is yet to show through in the Q1 figures. 2014 should, therefore, become increasingly busy for M&A activity.

The regions

Equity markets in the **U.S.** have flattened out in recent months, but they are showing signs of real underlying resilience in the face of some significant potential threats. Companies are looking to justify the high values being placed on them and growing by acquisition remains an increasingly popular option. Shareholder activism is also on the rise.

Latin America has had a quiet few quarters, but we expect to see activity pick up as the year unfolds. Appreciation of the U.S. dollar is making assets more affordable for inbound investors, and companies within the region are actively looking to do outbound deals.

Investor confidence in **Western Europe** is becoming more buoyant, even in markets still waiting to see real economic recovery. Q1 volumes of deals were down, but values held up well, often thanks to significant strategic deals. IPO activity is also increasing. The Ukraine crisis has not yet impacted on

CEE and CIS transactions as investors appear to be biding their time.

It was a decidedly quiet time for **MENA** transactions, against a backdrop of continuing political uncertainty in key markets. However, we expect livelier activity later in the year, not least with international private equity funds taking a growing interest here.

India remains locked in a pre-election slowdown and the results of the poll are crucial to the future direction of policies that will have a big bearing on activity later in the year.

The **Asia Pacific** region divides into two distinct halves. North Asian markets remain busy, with pharma and real estate particularly active in Greater China. ASEAN economies remain in a lull in activity, but a strong rebound in currencies and equity markets, after last year's volatility, bodes well.

The sectors

The usually resilient **energy** sector remains remarkably quiet. Continuing oil price uncertainty makes it difficult to value assets, but otherwise, conditions are increasingly ripe for transactions. The Ukraine crisis could have a further negative impact, but, to date, does not appear to have unsettled investors unduly.

Financial services companies, particularly banks, remain focused on restructuring rather

than doing new deals and it could be some years before they have reconfigured their operations and return to the acquisitions trail.

The **infrastructure and utilities** sector continues to wrestle with a now-familiar problem – an excess of capital chasing too few good-sized assets. Some markets – notably Scandinavia – are bucking the trend, and new asset classes are gaining popularity. Some are classic infrastructure, such as broadcasting towers; others, such as lotteries, are more unusual, although proving popular as they offer the prospect of stable, long-term returns of the sort funds require.

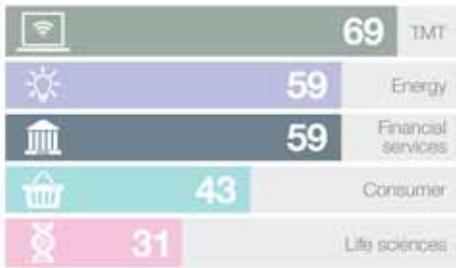
In the **life sciences** sector, the big pharma companies continue to focus on core activities, making strategic investments and disposing of assets involving peripheral activities.

Despite having huge financial firepower, **PE** funds' primary focus is on secondary buyouts and exits, although the U.S. did see some big standout deals in Q1. TMT and life sciences assets are attracting growing interest.

Telecoms, media and technology continue to show the greatest signs of activity and we expect deal flow to remain strong. The social media giants continue to search for deals, with each head-to-head pushing up asset prices. Cable TV is also a key battleground, particularly in Europe.

Global M&A in numbers Q1 2014

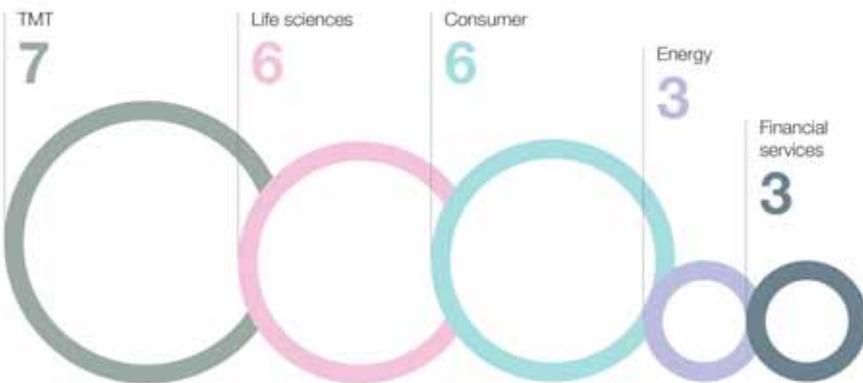
Top 5 sectors by volume



Deal types by volume



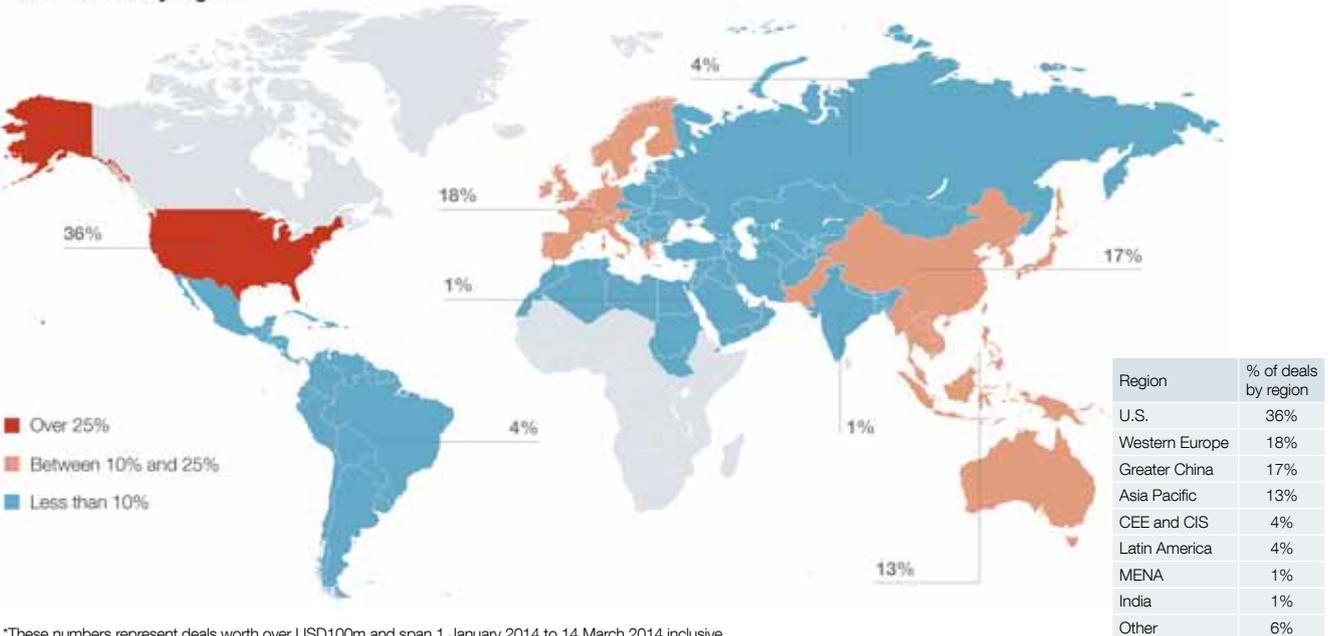
Top 5 sectors by megadeal (deals over USD2bn)



Significant increase in the value of deals



Deal volumes by region



*These numbers represent deals worth over USD100m and span 1 January 2014 to 14 March 2014 inclusive

In focus

Post-merger integration: the people challenge

For many reasons, surprisingly few M&A transactions achieve the results hoped for by investors. Could that change if dealmakers were more aware of the need to manage the complex employment issues that inevitably arise before and during integration?

Despite all the long planning that goes into preparing an M&A transaction, a remarkably small number actually end up producing the hoped-for results. Indeed, some estimates suggest that as few as 20% of deals achieve the benefits a buyer was banking on.

There are, of course, many reasons for this low success rate. But it is undoubtedly true that one major factor is the lack of awareness that goes into planning for and managing the complex employment issues that inevitably arise when two organisations come together.

If handled badly, such changes can damage productivity, erode employee engagement, delay value creation, damage relationships with customers and clients, as well as market reputation/position and, in extremis, lead to expensive legal procedures and even strike action.

If handled well, the exact opposite is true.

Planning and managing the employment, human resource and people integration aspects of any transaction will, therefore, always be critical to the success of a deal. This is particularly the case where the transaction impacts across a number of different jurisdictions where you have to manage not only different legal and regulatory requirements, but also different cultures and employee consultation requirements.

Allen & Overy's bespoke employment restructuring online tool – covering 35

different jurisdictions – is a useful resource for mapping the different legal requirements that will need to be met in completing a cross-border deal.

But the transaction team needs to devote equal, if not greater, resources to understanding the cultural differences of the markets it is targeting and fully focus on achieving best practice, whether or not that is a requirement of the local law. The key message here is clear: even if common standards do not apply, common sense should.

Careful planning at every stage

At every stage of the transaction – before, during and after – the team needs to ensure that both short- and long-term employment issues are taken fully into account along with other leading concerns, whether economic, regulatory or tax-related.

Creating a balanced team with the right levels of expertise in all these areas is essential. Too often, investors – particularly those from less regulated markets such as the U.S. and the UK – skimp on addressing the people issues. They can end up paying a heavy price for regarding them as something that can be mopped up later.

Where employment issues are concerned, detailed forward planning is a must. Even the structure of the deal will have an impact on the post-deal integration strategy and the legal requirements that will apply.

These will tend to be less onerous in a share deal where the identity of the employer does not change. But if the deal is structured as an asset sale, more difficult issues arise. EU countries insist that existing employment terms are safeguarded when assets change hands. Some non-EU countries, such as Singapore, Canada and New Zealand, offer similar protection to some employee groups.

The importance of being open

Effective employee communication during the deal and in any subsequent reorganisation is essential, not optional. Transactions and restructurings are notoriously anxious times for employees. Speculation is rife; uncertainty abounds. Poor communication can be a damaging drag on morale, performance and motivation and disrupt a smooth transfer of ownership.

We have seen examples where poor communication has caused major problems both in markets that are heavily regulated, such as Belgium, as well as in markets where regulations are perceived to be less strict, such as China.

So, it is important both to meet local legal requirements on information and consultation and to build a system of internal communications that allows employees to express worries and have their say. Nowhere is this more important than when the main purpose of the transaction is to acquire and retain people with sought-after



“There is a lack of awareness that goes into planning for and managing the complex employment issues that inevitably arise when two organisations come together.”

skills in the target company – often a priority in IT transactions, for instance.

If redundancies follow a deal, it is important to think about those who face severance and those who will stay. The latter group will make judgements about you as an employer based on how you handle that process.

If there is a loss of trust, this can easily persuade key personnel to vote with their feet and look for a job elsewhere.

But getting the timing right for informing and consulting is a tricky process, not least in EU jurisdictions where the law insists on proper communications with works councils (both local and any European Works Council (EWC)) and other local representatives. Some countries – Germany, France and the Netherlands, for example – apply stricter rules on works council consultations and the process can be more drawn-out. Even in less strict regimes, Poland for instance, investors should expect the process to take up to two months.

But coordinating the process on a cross-border deal is even more complicated, particularly if there is a danger of news leaking out. Employees never appreciate hearing news of a deal or a restructuring second-hand through the press or on the commercial grapevine. The same applies

in those jurisdictions such as Germany, France, Luxembourg and Spain, where the law insists on some redundancy programmes being supported by a detailed social plan, offering those laid off proper severance rights and opportunities to be retrained and redeployed.

That makes it essential to draw up a careful timeline for the communications strategy, with early notification built in. It is vital, too, to ensure that the message being given in different countries is always consistent, delivered by people who know the business case inside out and can give clear answers to employees and their representatives.

Retaining key people

Strategies for retaining key people post merger vary widely from market to market. In some, notably the U.S., the emphasis is often on short-term financial incentives, even though section 409A tax regulations, brought in after the Enron debacle, mean that these can potentially fall foul of the law if not structured correctly.

But often, a more subtle and long-term approach can pay bigger dividends. In our experience, there is no ‘one-size-fits-all’ option. Diverse groups of employees require diverse approaches.

But it is worth remembering that employees will most likely want assurances that the new business has a strong and sustainable strategy, well thought-through growth plans, and that it offers them reasonable long-term job security. Financial incentives are important, but are unlikely to be enough on their own. Again, effective communications here have a very high value, yet it is a value that all too many investors fail to recognise.

Striving for best practice

This is a complex area of the law. The best approach is to go beyond pure focus on legal compliance by building strategies that also take full account of differing cultural expectations and market standards in human resource planning.

The overall goal is to achieve best practice in tackling the people challenges. More often than not, that offers the very best guarantee that a transaction will achieve the wider commercial benefits that were intended.

The second edition of ‘The Big Think’, a briefing paper from Allen & Overy’s global Employment practice, will investigate these issues in greater detail. This will be available from mid-May at www.allenoverly.com/thebigthink

Regional insights

Last year's trends have continued in 2014. The U.S. continues to be increasingly active, Europe is beginning to recover, while progress is slow in the Middle East. China is busy, but much of the rest of Asia seems becalmed.

U.S.



After a buoyant end to 2013, U.S. equity markets have flattened out in the first three months of 2014. But, encouragingly, they have not tumbled in the face of some significant potential shocks. The Ukraine crisis, China's continued slowdown, and some poor domestic indicators (many induced by a fierce winter that has disrupted consumers and travellers) have effectively been shrugged off by the markets – proof of their underlying resilience.

CEOs know that they have to justify the high valuations being put on their businesses by the markets and have two main options – to grow organically or by acquisition. Many are taking the latter option increasingly seriously and we have seen some good-sized transactions in Q1, the majority within the U.S. but across a wide range of sectors.

Tech companies have been busy, as we saw with Facebook's USD19 billion acquisition of WhatsApp, Comcast's USD45bn deal to buy Time Warner Cable, and Liberty Global's successful EUR10bn acquisition of Dutch cable operator Ziggo. In the retail sector, the quarter also saw Safeway, the second-

biggest supermarket chain, acquired by PE fund Cerberus for USD9bn.

There has been good activity in the life sciences sector, with Johnson & Johnson selling its Ortho-Clinical Diagnostics business to PE group Carlyle for USD4bn. Forest Laboratories, which had been the subject of an extended activist campaign by Carl Icahn, also agreed a USD25bn takeover by Actavis, the acquisitive Irish group. Dow Chemical announced plans for up to USD2bn of disposals as it moves away from a reliance on petrochemicals to focus on electronics, agriculture and packaging. Dow had also attracted activist attention, in this case from Daniel Loeb.

The IPO market continues to see a pick-up in activity. GE and Hertz have both announced plans to spin off businesses into standalone quoted companies – in GE's case, its credit card and retail banking arm. IPO activity points to a strong return of confidence in the U.S. capital markets and that was forcefully underlined by the decision of Alibaba, the Chinese internet giant, to float shares in New York rather than Hong Kong.

Overseas investors are also beginning to hunt out traditional M&A deals in the U.S. to take advantage of economic recovery there. Equally, some U.S. businesses are stepping up their search for assets in other markets, notably Europe. But for now, the focus remains predominantly on the home market.

Latin America



After a relatively quiet period for transactions across Latin America, there are now clear signs that the market is set to pick up in 2014.

Brazil, Mexico, Peru, Colombia and Chile are seeing growing activity, with a healthy pipeline of potential deals building. Mexico, in particular, is attracting growing interest following a raft of important economic reforms in key sectors such as energy. Its close ties to the U.S. also means it is feeling the beneficial side effects of economic recovery across the border. Argentina, Venezuela and Bolivia, however, remain much tougher markets and are likely to remain so.

Increased activity will, we believe, be driven by the appreciation of the U.S. dollar against local currencies, increasing the purchasing power of inbound investors.

That is particularly important for PE funds that have, clearly, been deterred from making investments by high asset prices. The end of the quarter saw Bain Capital sign agreements to acquire Intermedica, the Brazilian health insurance and hospitals group, for an estimated USD851m – a sign, perhaps, that buyer and seller price expectations are coming closer together.

“German transactions continue to be dominated by sizeable strategic deals.”

But we also expect to see Latin American companies – whose focus has been mostly domestic or intra-regional up to now – making outbound investments in the coming months in markets as diverse as Asia, Europe and the U.S. Hot sectors are likely to be food and commodities. Financial services could also be lively. Brazil, for instance, has a number of very well capitalised banks looking for opportunities in new markets.

Brazil, of course, is hosting the football World Cup this summer and the Olympics in two years’ time and both have provoked popular protests. But investors remain quite calm about the outlook, their sights fixed on the relatively benign economic fundamentals.

Standout Q1 deals included the acquisition of GlobeNet, a Brazilian submarine cables business, by the PE division of BTG Pactual, a deal we advised on and which closed in January. The transaction involved both a USD366m syndicated loan and a local debenture issue worth USD274m.

Western Europe



2014 has kicked off in the same way 2013 ended, with Western European transactions continuing to fall in volume, but values holding up well, often thanks to significant strategic cross-border transactions.

However, as we reported last time, the figures do not reflect the level of behind-the-scenes activity we are seeing and we remain convinced

that the year ahead will be increasingly busy.

Even in markets where economic recovery has yet to take hold, there is a growing sense of optimism among investors. The Netherlands is a case in point. Despite a general view that recovery is still about a year away, confidence is growing, a healthy pipeline of deals is building and there are signs that the IPO market will soon be active again.

There were also some standout deals here, notably the EUR10bn acquisition of cable company Ziggo by Liberty Global. Warner Bros. also swooped on the Dutch TV programme maker Eyeworks in a deal said to be worth USD274m and giving Warner Bros. access to production facilities in 15 territories outside the U.S.

German transactions continue to be dominated by sizeable strategic deals and the real estate sector was exceptionally busy, with Deutsche Annington and PATRIZIA both making acquisitions in the EUR1bn range. But the mid-market is less buoyant and PE investors are currently much quieter on the buy side than we would have expected, although we have seen some big exits, including Carlyle’s EUR1.4bn sale of Veyance Technologies to Continental.

Significant Q1 transactions included RWE’s EUR5.1bn sale of its upstream oil and gas business to LetterOne, ultimately controlled by Russian tycoon Mikhail Fridman. Surprisingly, the deal was announced on the day EU sanctions against Russia were published. Volkswagen also moved to take control of the remaining shares in Scania in a EUR6.7bn deal.

The French market continued the recovery trend seen in Q4 2013 and it looks like we could be heading for a record year (not seen since 2007) if the transactions announced,

and those in the making, complete.

Transactions such as the strategic investment of Dongfeng in Peugeot Citroën for more than EUR1bn and the sale of SFR for around EUR15bn, illustrate the strong level of activity we are seeing. The sale of SFR is attracting a lot of attention in the media and from the French government, given the unprecedented competition that has emerged between Numericable and Bouygues Telecom to secure the much-desired position of the number three telecom operator in France. Lafarge has also just confirmed rumours of a proposed transaction with Holcim. Capital market activity has also risen dramatically in the first quarter of 2014. On a less positive note, the recent amendment to the takeover rules may act against hostile takeovers, giving managements more tools to frustrate non-solicited offers.

Although deal volumes in the UK were not significant, there is a noticeable increase in confidence among companies. That is, no doubt, partly due to the booming IPO market, with deals like Poundland’s GBP750m IPO providing an exit for its PE owners and Circassia’s GBP175m IPO being the largest biotechnology IPO in the UK for 20 years. It also reflects a more general expectation of stable economic conditions. This has meant that companies are looking at a wide range of deals, from the transformational (such as Carphone Warehouse’s proposed merger with Dixons) to the strategic (like Rexam’s USD805m sale of its pharmaceutical devices and prescription retail business and Google’s acquisition of DeepMind Technologies, the UK technology start-up). We expect a significantly stronger M&A market for the year.

CEE and CIS



M&A transactions in the CEE and CIS region have been low in recent quarters, with domestic deals dominating the scene and all but a few sectors, notably oil and gas, relatively quiet. The Ukraine crisis has introduced a new level of uncertainty and has had an immediate impact on the currency, capital markets and capital flight.

Reading the situation is complex, however. Views among investment bankers and lawyers seem to divide into two distinct camps. The optimists tend to believe that the sanctions will not be ratcheted up further, that the U.S./EU and Russian sides will de-escalate and that there will be a return to normal business later in the year.

The more conservative observers worry that the crisis has much further to go and that tit-for-tat sanctions could cause longer-lasting damage. Anecdotal evidence suggests that market sentiment may be stabilising but, in truth, for most investors, it is a case of watching and waiting. One impact, however, could be for Russian outbound investors to look to the other BRIC nations for deals, as well as developing stronger business partnerships with these countries, notably China and India.

Ahead of the crisis we saw some substantial deals, but many were follow-on transactions spurred by earlier deals rather than new activity, with shareholdings being moved between a number of state-owned enterprises. Talk also persists of a number of major privatisations, but it remains to be seen whether the timing of these will remain on track. Noticeable transactions in Q1 included the sale of his remaining stake in the Russian leading social network VKontakte by its founder Pavel Durov (software), and the

announced acquisitions of an increased stake in Uralkali by ONEXIM Group (mining) and Rosneft of Orenburg Drilling Company (oil and gas services).

The M&A activity in Poland in Q1 2014 has been very limited, with no major deals announced during that period.

Further south, deal activity is definitely picking up, even if we are only in the early stages of recovery. The statistics suggest Q1 has been one of the quietest quarters since 2008/2009 but they belie a more dynamic situation on the ground. Requests for proposals are increasing and we are seeing a growing number of deals progressing to the due diligence stage and beyond, indicating that many of the mulled deals now have legs.

We are seeing some cross-border activity in Hungary. OTP, Central Europe's biggest independent lender, has agreed to acquire the Croatian interests of Italy's Banco Popolare, and energy group MOL continues to look for oil and gas assets in the North Sea and the Middle East. We expect to see more of this activity in later quarters.

The proposed sale of Slovakia's Towercom is at an early stage but attracting interest from PE and infrastructure funds, while in Slovenia, the sale of Telecom Slovenije rumbles on, and a sale team has been assembled for NKBM, indicating that there is still steam in the country's much-needed privatisation programme.

Activity in the Czech Republic in Q1 was dominated by completion of the EUR2.46bn acquisition of Telefónica Czech Republic by PPF Group from Telefónica SA. The acquisition will be followed by the public mandatory buyout. Another significant transaction was the departure of E.ON from Prague gas distribution company Pražská Plynárenská. E.ON's stake was acquired by the City of Prague which, after some internal reorganisation, is expected to further sell a portion of its shareholding to another investor. Increased activity by PE funds and continuing sales of family-owned businesses are also expected to continue in Q2 of this year.

Middle East and North Africa



Q1 began as the last quarter ended for deal activity in the Middle East and North Africa – on a decidedly quiet note, with both the volume and value of deals at a low level. However, there has been a noticeable uptick in the number of deals in the planning since the start of the year and in North Africa we are continuing to see deals between African players, notably in financial services and insurance.

So, with the deal pipeline building, the outlook for the rest of the year would appear to be much more positive, especially as there are signs that international PE funds are increasingly looking to do regional transactions. We also expect a growth in equity capital markets deals, with a number of companies planning IPOs later in the year.

Political uncertainty remains a key feature in some markets, but here, too, there are signs of hope. Elections in Algeria could promise greater stability, tensions in Tunisia appear to be calming and Morocco is expected to grow more strongly this year. Egypt, where presidential elections start in late May, is a tougher call, however.

Standout deals in Q1 did, however, include an announcement from the Abraaj Group that it is to invest in Cairo for Investment and Real Estate, an education company listed on the Egyptian stock exchange – evidence that some investors are prepared to look beyond immediate political risks to do important deals. We expect to see continued investment across the region in soft infrastructure sectors such as education and healthcare.

Other notable deals included Rexam's acquisition of a 51% stake in Saudi Arabia's United Arab Can Manufacturing, a supplier

“Even in markets where economic recovery has yet to take hold, there is a growing sense of optimism among investors.”

to The Coca-Cola Company, and Etisalat's USD5.6bn acquisition of Vivendi's 53% stake in Maroc Telecom, which is expected to close in May.

India



In the run-up to April's general election, India's M&A market has, not surprisingly, remained very quiet.

Much hangs on the drawn-out election process – the final results will not be known until early June – and the shape of the new government.

Many investors are pinning their hopes on the BJP, led by Narendra Modi, gaining a decisive majority so that it can carry through a range of promised pro-business policies. But India has a long tradition of complicated coalition politics, so the precise outcome of the poll will dictate the pace and scope of any subsequent reform programme.

India goes to the polls in better economic shape than last year, when rapid devaluation of the rupee was exacerbating two longer-term problems – a large balance of payments deficit and galloping inflation. A tightening of monetary policy under a new central bank governor has helped and, depending on the election, many predict less volatile times for the currency in 2014.

Recent economic reforms – including a new Companies Act that, among other things, includes specific far-reaching provisions on corporate responsibility – should also have a significant impact on the transactions market. But, again, politics will decide if these reforms are carried forward as planned or clawed back.

Q1 did see some interesting deals, both domestic and cross-border. Bharti Airtel reinforced its market leadership by acquiring mobile operator Loop Telecom for USD113m, the first merger in a sector which many consider ripe for consolidation. In common with many other Indian companies looking to improve their balance sheets, Lanco Infratech

sold off a hydro project and two smaller power plants to Greenko Energies, based in Hyderabad, in a USD104m deal that will help it reduce debt.

PE house Carlyle was involved in a significant cross-border deal which saw France's Groupe Lactalis acquire Tirumala Milk for USD275m from the fund and the original owners. This is part of a pattern of disposals by PE houses that are now looking to make exits as funds reach the end of their life.

Asia Pacific



Asian markets divided into two distinct halves in the first quarter of the year, with ASEAN economies remaining becalmed as in the second half of 2013, but north Asia, most notably greater China, showing much greater signs of activity.

Despite continued worries about a slowdown in China's growth, the appetite of investors to do deals within, into and from China appears to show little sign of flagging. Not all the activity we are seeing has yet shown up in the statistics, but we are confident that a good pipeline of bilateral, cross-border deals is building across a wide range of sectors.

Real estate is particularly lively. Specialist international funds are busier than ever scouting for deals on good terms, notably in the commercial space. Residential property, where talk of the market overheating persists, is a different story and we expect to see Chinese developers continue to seek outbound opportunities.

The pharma sector is lively, too, indicating that last year's GSK anti-bribery probe by the Chinese authorities has not dented the enthusiasm of other big players to tap growing demand for western medicines among the country's burgeoning middle class. Investors are, though, taking much greater care on pre-deal due diligence.

While domestic deals dominate in China, Q1 saw some significant outbound deals,

and not just from the big state-owned enterprises that have tended to dominate in the past. Most notable was computer maker Lenovo's move to buy the smartphone business Motorola Mobility and IBM's server operation for a combined USD5.2bn – a significant move by a Hong Kong listed company with clear global ambitions.

Politics is playing a big part in holding back activity in ASEAN markets, not least in Thailand and in Indonesia, which is approaching a drawn-out election running through to mid-summer. Myanmar is now attracting real interest, but most investors, with the notable exception of Japanese buyers, are taking their time to commit. Vietnam is relatively quiet, although real estate is a livelier sector here, also.

Nevertheless, we have seen some interesting deals, notably in the financial services space. Hiscox's deal to buy DirectAsia, targeting the growing online insurance market, is one, while Société Générale has continued the ongoing trend of western institutions disposing of Asian assets with the sale of its Singapore and Hong Kong private banking division to DBS.

There are some positive signs, though. Last year's jittery market reaction to the Federal Reserve's decision to taper its bond-buying programme is a thing of the past. Equity markets are calmer and there has been a strong rebound in key currencies, with Indonesia's gaining some 8% to 9%. High asset prices – which have left many international investors, particularly PE funds, feeling priced out of the market – are now at more reasonable levels. Recovery is unlikely to be fast, but it should get progressively stronger through the year.

Deal activity in Australia in the first quarter was largely as expected – solid without being strong. But the pipeline is filling and we expect a good first half, with numerous deals, both cross-border and domestic, seemingly on track for Q2 or Q3. Deal size also seems to be increasing. Energy, infrastructure and real estate continue to be attractive sectors for investors and several PE exits are continuing. With the IPO market being more discerning in 2014 compared with the last half of 2013, we expect a more balanced split between IPO and trade sale exits by sponsors.

Sector insights

TMT is showing the greatest signs of current deal activity, and, with healthy pipelines building in the sector, and investors eager to do transactions, 2014 should be busy.

Energy



Rapidly improving fundamentals in the energy sector

M&A activity in the energy sector remains at a very low level, with deal volumes down to just 59 compared with 87 in Q1 last year, and values almost halved to USD35.7bn. This continues a trend we have been seeing for the last six to nine months, but the real question, given rapidly improving fundamentals, is: why?

Finance is readily available, companies have plenty of their own capital to spend, there is no shortage of decent assets, and confidence in the sector is also noticeably more buoyant. Although continuing oil price uncertainty makes it hard to value assets with any real confidence, there is little else to stop investors doing deals in a sector which bucked the trend and continued to see a steady stream of transactions even at the height of the downturn.

The Ukraine crisis would appear to be a significant negative factor, particularly for existing and potential investors in Russia's huge oil and gas reserves. It is early days, but, so far, the impact has not been great. Indeed, RWE successfully offloaded its RWE Dea upstream oil and gas assets to LetterOne, controlled by Russian tycoon Mikhail Fridman, for approximately EUR5.1bn even as the crisis unfolded.

The US shale gas rush has taken a pause for breath in recent months. With gas prices coming down rapidly, some early investments are now looking expensive and we are seeing holdings being reduced (and written down) as the initial investors look to recoup some of those high upfront costs and spread the cost of development. We have seen a similar process at play in the Australian LNG sector. However, we are convinced the development of pipelines and other associated shale gas infrastructure will provoke a much greater amount of M&A activity in the short to medium term.

Q1 did see some important transactions, including the EUR1.1bn privatisation of Bord Gáis Éireann (Bord Gáis) – part of a EUR3bn package of asset sales agreed with the EU-IMF as part of Ireland's bailout. The buyers of Bord Gáis' energy business are Centrica and two infrastructure funds, iCON Infrastructure and Brookfield.

Asia Pacific remains similarly quiet. The outbound activities of the Chinese NOCs have slowed and some see this as a period of consolidation after the considerable business of recent years. There does seem to be more of an appetite for investment into the Chinese upstream sector as that area seems to become more open to foreign participation. Japanese oil companies and trading houses remain active in considering investments in upstream developments or acquisitions, although the worsening balance of payments position (driven largely by high oil and LNG prices), and moves towards liberalisation

in domestic arrangements, create uncertainty here. Government moves towards the re-balancing of the Korean economy and public sector are also seen to provide opportunities for activity. Of the current activity and early prospects, the theme of disposals by international oil companies remains the primary one. Many of those companies are from the Americas and there is a trend of realising the value of assets held in Asia Pacific to increase spending closer to home.

Financial services



Disposals of non-core banking activities continue

Deal volumes and values continue to decline in the financial services sector, reflecting the time it is taking financial institutions, most notably banks, to restructure their operations in the long wake of the financial crisis. Q1 saw a repeat of the trends that have been with us for many months now.

Some transactions are getting done, but they are tending to take much longer to complete – reflecting continuing market uncertainty as banks absorb and adjust to the avalanche of new regulation they face. The statistics speak for themselves. Q1 saw just 59 deals, compared to 65 this time last year. Total deal value fell from USD40.5bn in Q1 2013 to USD29.6bn in Q1 2014.

“Slowly but surely, the work to refocus businesses will feed through into transactions.”

The process of disposing of non-core banking activities continues, although with a great deal of this work already done, asset sales are undoubtedly getting harder to complete. For example, Société Générale’s sale of its Singapore and Hong Kong private banking business to DBS – part of a continuing trend of divestment by European banks in Asia – was one of the few deals in the region in Q1, as auctions and other sales processes continue to be drawn-out affairs.

All banks staged significant strategic reviews of their operations post-Lehman, and slowly but surely, the work to refocus businesses will feed through into transactions. But first, the relentless effort to boost competitiveness will see many restructure mid- and back-office operations, and, again, this is painstaking work. In reality, it will take some ten years from the onset of the crisis to fix the financial system. Only when that process is complete will we see a return to high levels of M&A activity.

For now, we are seeing pockets of activity, much of it concentrated within selected domestic markets. It is interesting to note that four transactions in Scandinavia – OP-Pohjola Group’s acquisition of the remaining 62.8% stake in Pohjola Bank;

Jyske Bank’s purchase of BRFkredit, creating an integrated mortgage credit group in Denmark; Swedbank’s takeover of Sparbanken Öresund in Sweden; and the recently announced acquisition of Nets Holding by Advent International, Bain Capital and ATP – accounted for more than 50% of the total value of financial services deals in Western Europe in Q1.

Other markets, notably Canada, which weathered the financial crisis well, are continuing to drive what cross-border activity there is, as we saw with Bank of Montreal’s GBP700m acquisition of F&C Asset Management in the UK. The Royal Bank of Canada has already built up an impressive presence in the UK asset management sector.

The Industrial and Commercial Bank of China (ICBC), the world’s largest bank by assets, also acquired 60% of Standard Bank’s commodities and currencies arm to gain a first foothold in the London wholesale market. The move continues ICBC’s gradual entry into the European market, part of the continued international expansion by Chinese banks. A recent IIF report noted that the number of branches, subsidiaries and representative offices that Chinese banks have outside China

has increased tenfold between 2006 and 2012, with a corresponding growth in assets in these countries and regions from USD227bn to USD1 trillion.

JPMorgan Chase’s disposal of its physical commodities arm to Mercuria Energy Group for USD3.5bn, by contrast, underlines another trend – the retreat by the top investment banks from the physical commodities business in the face of political and regulatory pressure. Here, revenues for the top ten banks are down sharply from their 2008 peak.

Infrastructure and utilities



An excess of capital chasing a paucity of good-sized assets

As we highlighted in our last report, the infrastructure sector continues to have one overriding issue – an excess of capital chasing a paucity of good-sized assets.

So, it is no surprise that Q1 saw a continuation of the quiet market conditions we saw at the end of 2013. Furthermore, compared to the

same quarter last year, activity was at a very low ebb, with just seven deals worth USD3.3bn completed, compared with 18 deals, valued at almost USD15bn, in Q1 2013. With the leading funds extremely well capitalised and staffed by big deal teams, the search for relatively scarce assets is intense and likely to push asset prices up.

One region continues to be busy, however. Following Fortum's pre-Christmas sale of its Finnish electricity grid to Borealis and First State infrastructure funds for EUR2.55bn, the group's Norwegian grid is now on the block, with the Swedish assets expected to follow later in the year. These Scandinavian deals are attracting widespread interest from international funds.

We are also seeing a number of broadcasting infrastructure transactions in several jurisdictions, including emerging markets such as Africa. Following recent deals – for example, Montagu's sale of Poland's Emitel transmission towers business to Alinda and the rumoured disposal of an interest in the UK's Arqiva – there are now signs of activity across Western and Eastern Europe.

UK water and airport deals are in a period of lull after intense activity in recent years. Investors are awaiting the outcome of a high-profile regulatory price review in the water sector, which still has some way to run, and the UK's enforced airport deals have now been done. Airport privatisations, however, are bubbling back onto the agenda in France, Spain, Greece, the U.S. and Japan. We are also expecting to see activity in energy infrastructure assets in the U.S. as the shale gas revolution creates an appetite for supporting infrastructure such as pipelines and LNG export facilities. This should provoke a healthy stream of M&A activity in the months ahead.

While this hiatus continues, investors' definition of infrastructure assets may become more elastic. Assets that share some of the attractive features of classic infrastructure – steady long-term returns and a safe regulated environment, for instance – are proving increasingly popular. Lotteries in Ireland, Greece and Turkey are cases in point.

However, the outlook remains relatively quiet, with a shortage of the sort of deals that have in

recent years done so much to drive volumes in this sector.

Life sciences



Big pharma continues to focus on highly strategic acquisitions

After a quiet end to 2013, the life sciences sector showed some sign of pick-up in the first quarter.

Deal volumes rose slightly on a year ago, while total deal values were up at USD56bn, although almost half that gain was down to one megadeal – the USD25bn acquisition of Forest Laboratories by Actavis. The deal continues a highly acquisitive run by Actavis, which last year swallowed Warner Chilcott, and is an important example of how generic drug makers are continuing to diversify into more innovative products.

Two other trends predominate. Big pharma companies are continuing to make often relatively small, but highly strategic, acquisitions to build their pipeline of products. Novartis is in advanced talks to buy Gamida Cell, the Israeli biopharma group specialising in stem cell technology, for an estimated USD600m.

At the same time, the big players are continuing to dispose of peripheral assets to focus more sharply on their core activities. Following GSK's decision to offload its drinks division last year, there is continuing talk that Merck will sell its over-the-counter health products business (including brands such as Coppertone sunblock and Claritin anti-allergy medicine) – a deal which could be worth approximately USD10bn.

2014 will see a number of important blockbuster drugs fall over the patent cliff, once again underlining the importance of pipeline-building. Where that is not possible, the major players are once again actively looking to access emerging markets where demand for Western medicines in a growing middle class is rising sharply. Interest extends beyond the BRIC economies, with Mexico, Indonesia, Nigeria and Turkey – the so-called

MINT economies – also increasingly becoming targets.

Circassia's IPO, valuing it at GBP580m, is one of the biggest of its kind to be staged in Europe by a biotechnology business. The interest in U.S. biotechnology offerings has not, to date, been matched in Europe, so this is an important test of investor sentiment.

Overall, we expect an increasingly busy 2014, not least as there are now signs of growing PE interest in the sector.

Private equity



PE funds have more financial firepower than at any time since 2007

Despite the ready availability of both loan and bond finance for new deals and the success many PE firms have had in raising new funds (the statistics suggest that PE funds now have more financial firepower than at any time since 2007), the focus for PE funds in mature markets in Q1 2014 has remained on selling existing businesses rather than acquiring new ones. In Europe and the U.S., therefore, we are seeing a continuation of trends we saw at the end of 2013, with deal volumes still declining and values remaining flat.

PE activity in the U.S. has been remarkably quiet, given the growing sense of economic confidence there, the tapering by the Federal Reserve of the financial stimulus package, and the noticeable pick-up in corporate transactions generally. There were just 15 U.S. primary buyouts in Q1, less than half the number seen in the preceding quarter, although there were some substantial deals, including the Cerberus acquisition of Safeway (USD9bn) and Carlyle's USD4bn purchase of Ortho-Clinical Diagnostics from Johnson & Johnson. In the U.S., as elsewhere, there has been far more emphasis on secondary buyouts and exits, as funds continue tweaking their portfolios – a process which has been ongoing for several years now.

Those funds that are in acquisition mode are also meeting much stiffer competition from well resourced trade buyers who can often

justify paying a premium on the basis of anticipated synergies with their existing business, although they do carry increased completion risk in the form of additional antitrust and regulatory hurdles.

TMT remains a sector attracting strong PE interest – particularly in Europe, where consolidation continues to be a major theme. In Q2, the proposed acquisition by Numericable (the French cable operator which staged a successful IPO in November 2013 but continues to have Altice, Cinven and Carlyle as substantial shareholders) of SFR, France's second-largest phone company, from Vivendi is attracting a lot of interest. It will also provide a lot of new paper for the debt markets if it is successful, although at the time of writing, Bouygues Telecom is still competing for SFR.

The life sciences sector is also continuing to attract growing interest from funds – Bain Capital, for instance, is purchasing the Brazilian health insurer and hospital operator Intermedica for an estimated USD851m.

Work continues on refinancing, extending or restructuring deals concluded before the financial crisis, although much of that work has been completed and the maturity wall has now generally been pushed back to 2016/2017. Unless they have previously been refinanced or extended, these deals will be starting to reach their final maturity in 2014.

Telecoms, media and technology



Very significant high-priced transactions in media and telecoms

While deal volumes fell for the TMT sector in Q1, it remained the most active sector for M&A. Deal values at USD141bn remained high, thanks to a number of very significant, high-priced transactions in media and telecoms. All the signs are that the sector will be increasingly busy as the year unfolds.

Notable Q1 transactions were Comcast's long-flagged but finally successful USD45bn merger with Time Warner Cable, one of the leading cable TV companies in the affluent New York market.

Cable TV was a dominant theme in Europe, too, where Liberty Global completed its EUR10bn acquisition of Ziggo. Liberty and Vodafone are now in an increasingly fierce head-to-head to dominate the European cable market, which suggests there should be further transactions in this space in the months ahead.

Social media companies continue to fight it out for valuable assets, whether as a defensive move or in a bid to bolt on new technologies and services to maintain their dominance in a

still fast-growing market. With all the main players scouting for deals, one clear effect has been to drive up asset prices. We saw this clearly in Facebook's decision to pay USD19bn for WhatsApp, the cross-platform mobile messaging business, in Q1.

Increasingly, we are seeing West Coast new media players searching for assets – and, more importantly, talent – in overseas markets. The big social media players are on the lookout for disruptive technologies like mobile messaging and video streaming. But the practice of 'acqui-hiring' – buying a business as much for its people as its technology – is on the up and the UK industry is becoming a major target. We saw this with Google's deal in January to buy DeepMind Technologies, the UK artificial intelligence business started by computer scientist and gaming specialist Demis Hassabis, for a reported GBP400m.

The decision by Alibaba, China's internet giant, to select New York rather than Hong Kong for its forthcoming IPO is being read as a sign of returning faith in the U.S. capital markets. The deal could be very significant, with some expecting it to outstrip Facebook's USD16bn IPO in 2012.

Deal flow is good for the TMT sector, globally, and we remain optimistic about its prospects in the year ahead.

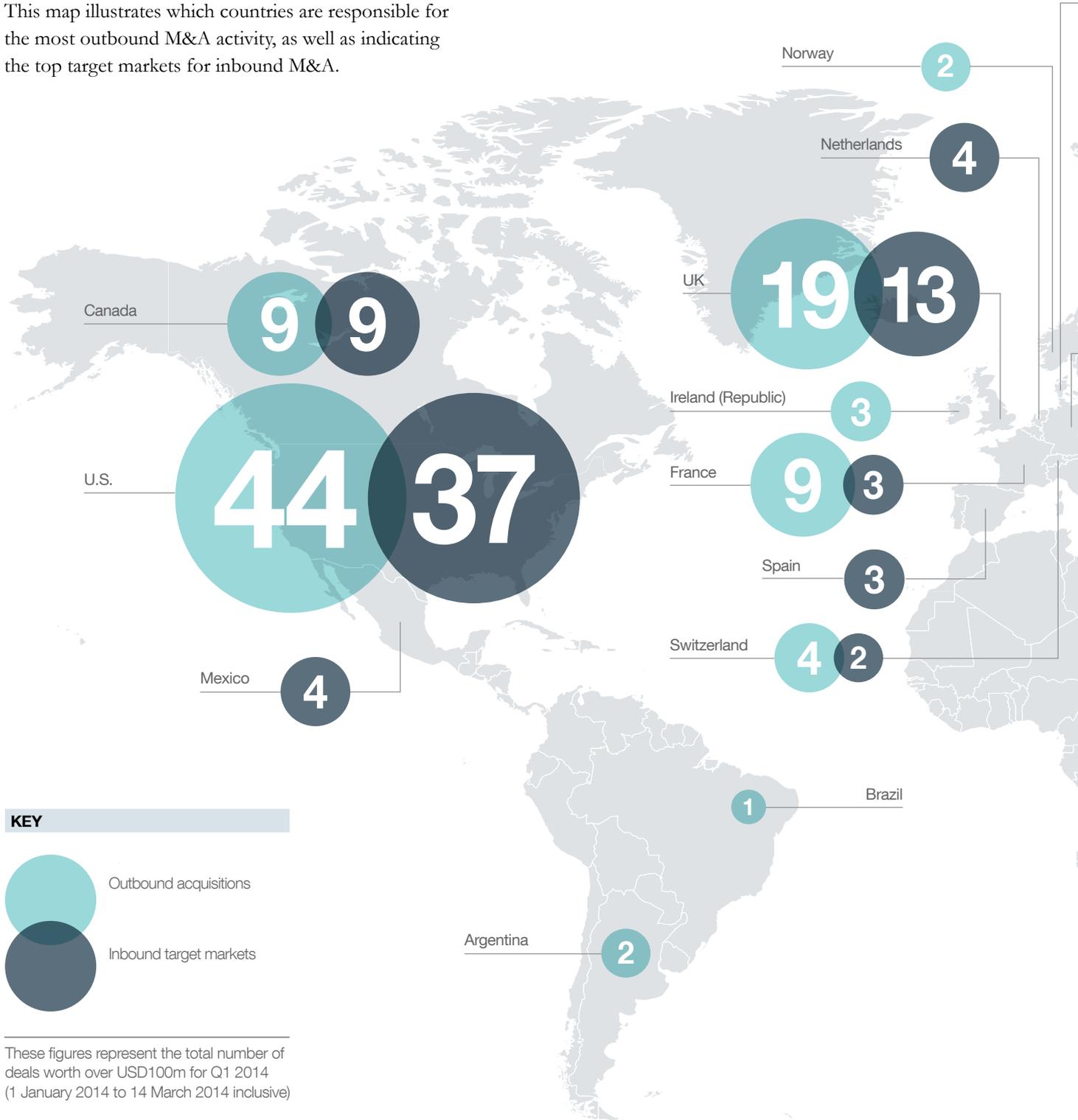
“The big players are continuing to dispose of peripheral assets to focus more sharply on their core activities.”



A global snapshot

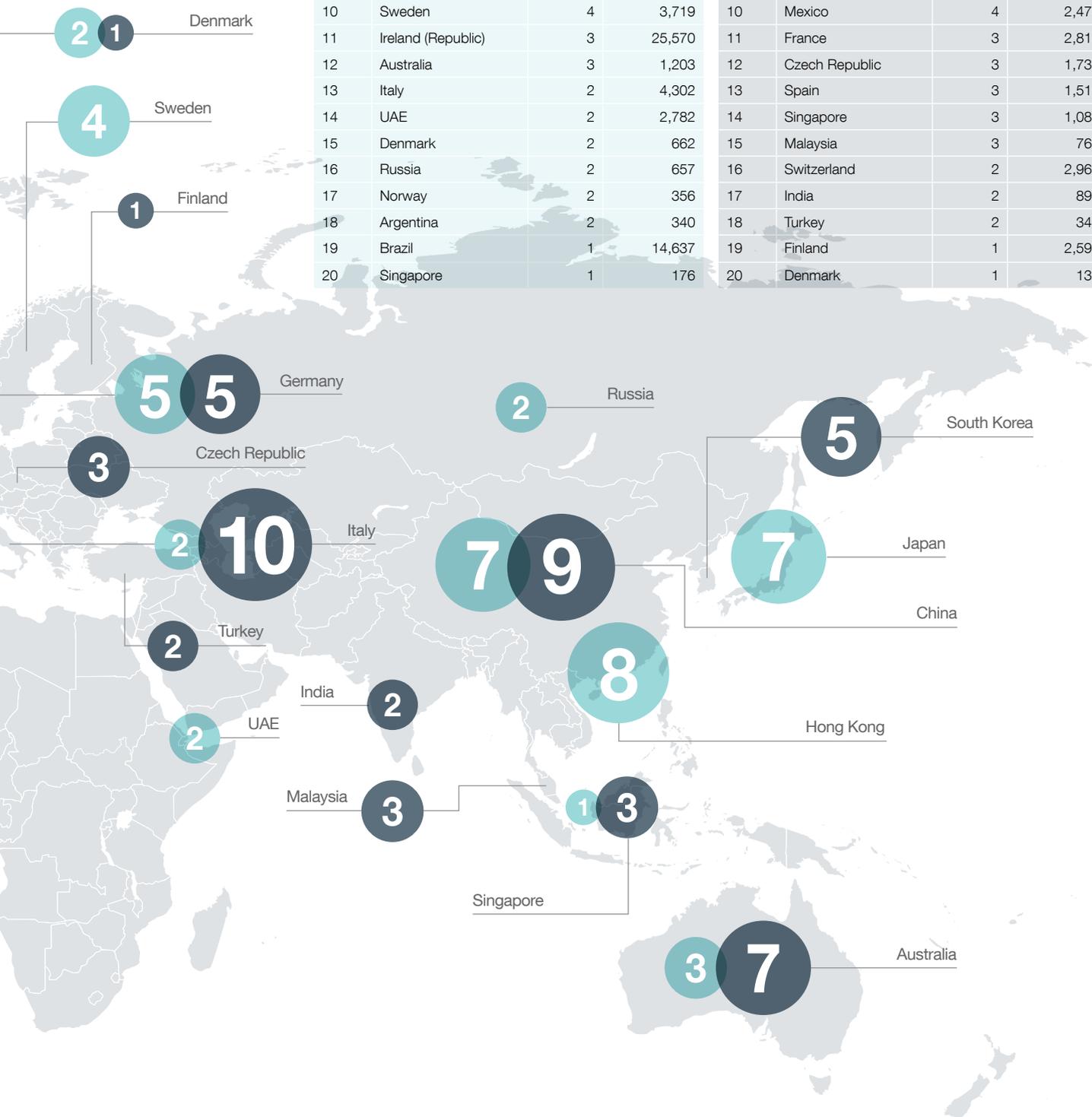
Top 20 global outbound acquirers and inbound target markets

This map illustrates which countries are responsible for the most outbound M&A activity, as well as indicating the top target markets for inbound M&A.



Outbound acquisitions			
Rank	Country	Volume of deals	Value of deals USDm
1	U.S.	44	38,376
2	UK	19	11,243
3	France	9	6,307
4	Canada	9	6,257
5	Hong Kong	8	5,625
6	Japan	7	17,371
7	China	7	8,918
8	Germany	5	13,576
9	Switzerland	4	5,677
10	Sweden	4	3,719
11	Ireland (Republic)	3	25,570
12	Australia	3	1,203
13	Italy	2	4,302
14	UAE	2	2,782
15	Denmark	2	662
16	Russia	2	657
17	Norway	2	356
18	Argentina	2	340
19	Brazil	1	14,637
20	Singapore	1	176

Inbound target markets			
Rank	Country	Volume of deals	Value of deals USDm
1	U.S.	37	69,802
2	UK	13	6,644
3	Italy	10	5,689
4	China	9	5,220
5	Canada	9	4,689
6	Australia	7	7,220
7	Germany	5	8,541
8	South Korea	5	8,064
9	Netherlands	4	13,300
10	Mexico	4	2,473
11	France	3	2,813
12	Czech Republic	3	1,732
13	Spain	3	1,516
14	Singapore	3	1,087
15	Malaysia	3	764
16	Switzerland	2	2,963
17	India	2	891
18	Turkey	2	341
19	Finland	1	2,597
20	Denmark	1	133

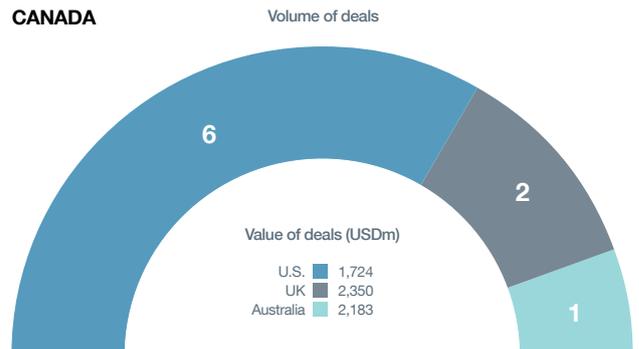
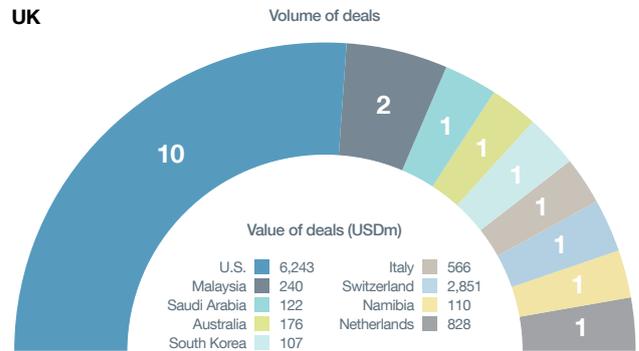


Top target markets for the world's largest acquiring countries

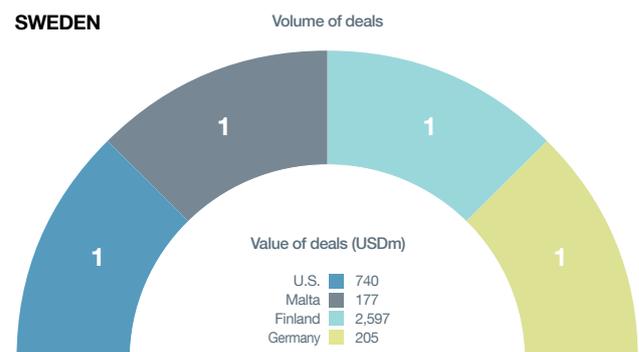
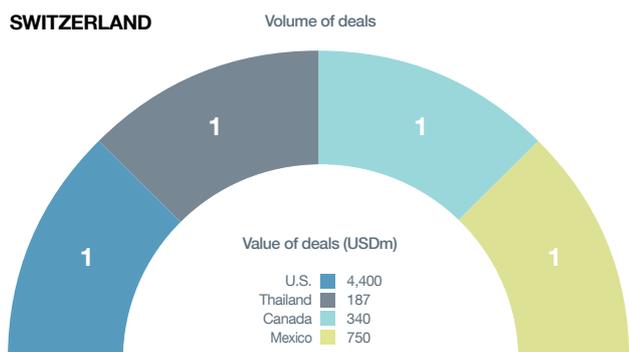
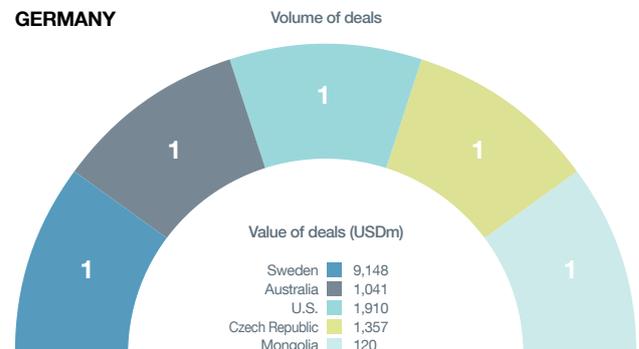
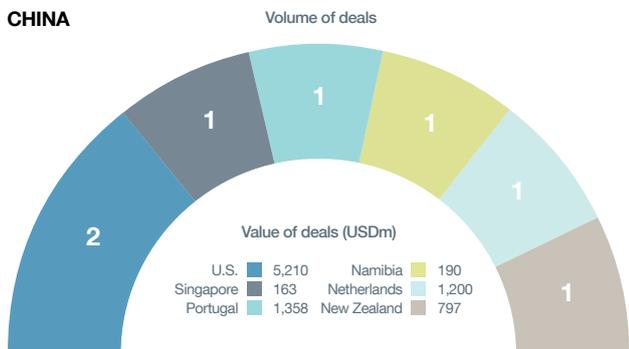
The charts reveal where the world's largest acquiring countries are carrying out deals. For each of the ten countries responsible for the most outbound M&A activity, the data ranks the top ten overseas target markets for M&A, by volume of deals.

Rank	Country	Volume of deals	Value of deals USDm
1	U.S.	34	32,685
2	UK	19	11,243
3	France	9	6,307
4	Canada	9	6,257
5	Hong Kong	8	5,625

Rank	Country	Volume of deals	Value of deals USDm
6	Japan	7	17,371
7	China	7	8,918
8	Germany	5	13,576
9	Switzerland	4	5,677
10	Sweden	4	3,719



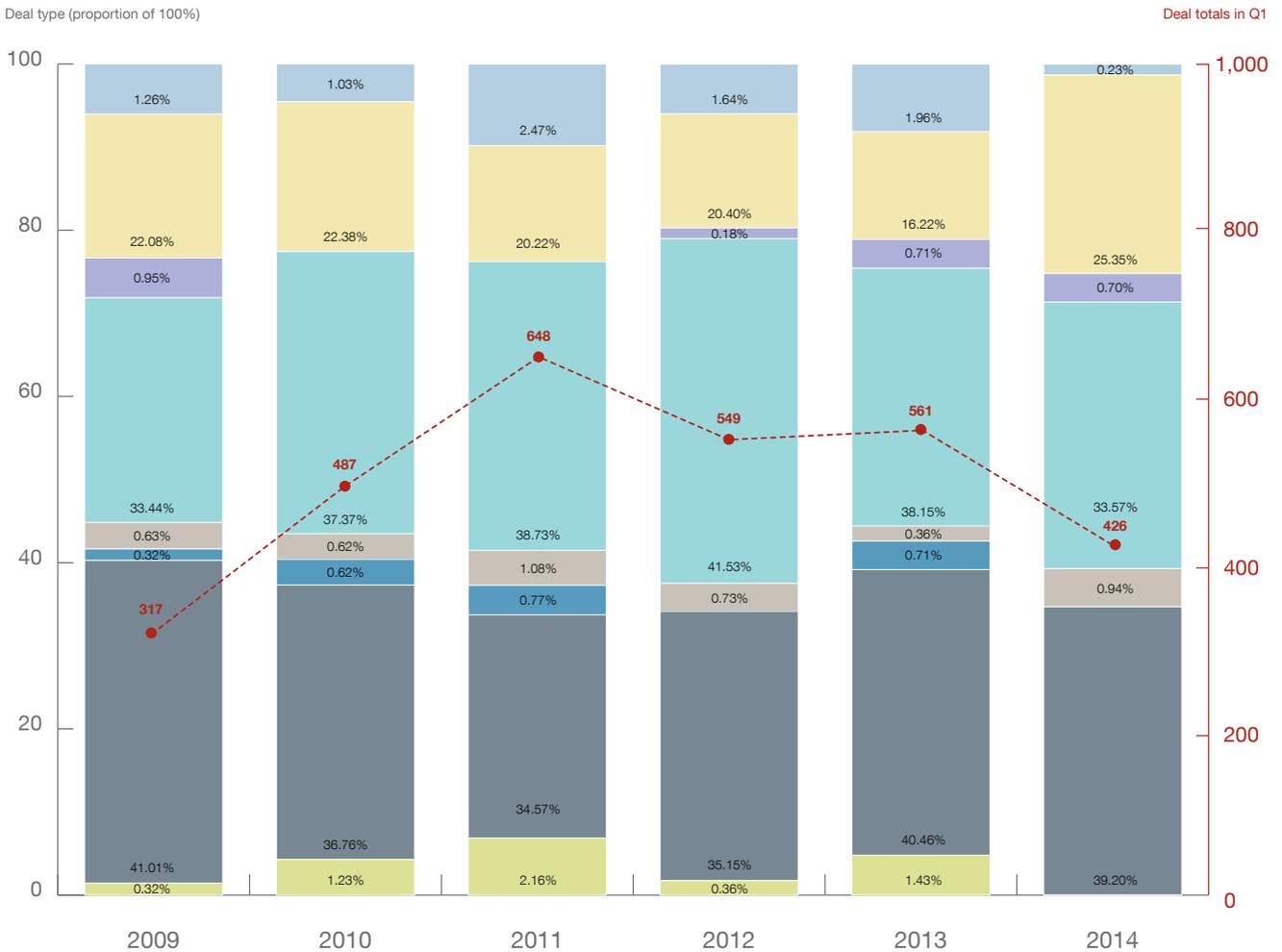
*These numbers represent deals worth over USD100m and span 1 January 2014 to 14 March 2014 inclusive



Global deal types: Q1 2009-Q1 2014

KEY

- Take private
- Public recommended acquisition
- Public hostile acquisition
- Other private M&A
- Merger
- Joint venture
- Divestment
- Demerger



The diagram above represents the breakdown of the total number of deals from 2009 to 2014.

Definitions

Divestment

A disposal where the seller is a corporate selling a controlling interest (>30%) in one or more of its businesses. This excludes private equity exits and disposals made by high net worth private individuals and families. Includes government-related sales and disposals made by non-private equity financial investors, such as investment holding companies.

Cross-border

A transaction that is conducted across national boundaries. The deal involves parties from at least two different countries.

Demerger

A transaction where a company spins off one of its subsidiaries, resulting in the creation of a separate listed business independent from the activities or influence of the former parent. The shareholders ultimately hold shares in each company and neither the former parent company nor shareholders receive any cash as a result of the deal (as opposed to a flotation/IPO).

Domestic

A transaction conducted within a national boundary. The deal involves parties that are incumbent nationals of that country.

Insolvency-related

A transaction where a company has filed for bankruptcy or is subject to another insolvency process or procedure, and sells off part or all of its assets to generate the cash necessary to pay creditors.

Joint venture

A transaction that involves the pooling of assets between different companies, whereby the ownership of the new joint venture is shared between the parent companies involved. Does not include so-called joint ventures where a company's sole contribution is cash rather than assets.

Merger

A transaction that involves the combination of two or more separate businesses into one, with broadly equal holding and governance rights assigned to the respective shareholders of each company.

Other private M&A

Acquisitions or disposals not covered by the other classifications. Includes PE exits and disposals made by high net worth individuals and families.

Public recommended acquisition (excl PE-related take privates)

A friendly acquisition where the parties involved reach agreement over the terms of the deal, normally prior to the acquisition being formally announced. The transaction requires approval from either the bidder, target or vendor shareholders in a public forum.

Public hostile acquisition (excl PE-related take privates)

An acquisition of a publicly-quoted target where the target management does not recommend the offer within two weeks.

Take privates (hostile and recommended)

An acquisition of a publicly-quoted company by financial investors such as private equity houses or venture capital firms (as opposed to a trade buyer). The target company is subsequently delisted.

About the research

The underlying data to this research comes from Remark's sister product, Mergermarket. Both products are part of the Pearson-owned Mergermarket Group.

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- This report only includes deals worth USD100m and over.
- The data contained in the Q1 2014 results spans 1 January 2014 to 14 March 2014 inclusive.

Allen & Overy: *M&A rankings, Q1 2014*

*1st in MENA by
volume of deals*

Thomson Reuters, Q1 2014

*1st in Benelux by value
and volume of deals*

Bloomberg, Q1 2014

*1st in Italy by
volume of deals*

Bloomberg, Q1 2014

*1st in CEE by
volume of deals*

Mergermarket, Q1 2014

*2nd globally for cross-border
deals by volume*

Bloomberg, Q1 2014

*2nd in the UK
by value of deals*

Thomson Reuters, Q1 2014

*2nd in Europe by
volume and value of deals*

Bloomberg, Q1 2014

*2nd in Hong Kong
by volume of deals*

Bloomberg, Q1 2014

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