

ALLEN & OVERY

M&A Insights

2019 H1

Where there's a will, there's a way

Where there's a will, there's a way

While deal values and volumes are trending downwards in most regions and sectors, investors are still willing to set political and regulatory uncertainty aside to execute big, strategic transactions when opportunities arise. That suggests that activity should remain relatively robust in the months ahead, despite a more challenging deal environment.

01 *Mixed signals from an increasingly complex world*



Note: Figures represent deals announced between 1 January 2019 and 30 June 2019

Data provided by
REFINITIV

The raw data point clearly to a decline in M&A activity across regions and most sectors in the first half of the year. Cross-border activity and the prevalence of mega-deals are also on a downward trend. Yet the picture is a little less stark than the numbers suggest.

While deal value and volume are down by 12% and 16% respectively, the first half of 2019 still stands as the third strongest on record for global M&A. It is also the third time the first half year has hit the USD2 trillion mark.

The slow down was not unexpected, not least in markets where geo-political and economic issues – slower growth, trade tensions and Brexit – now appear to be affecting confidence in some boardrooms, even though they have been on the radar for some time.

Nevertheless, there is plenty of evidence that companies are prepared to take on big strategic deals when opportunities arise.

The difference is that they now do so with a clear expectation of greater complexity, as those political issues translate into greater regulatory intervention. We see this particularly in the rise of new merger controls around perceived threats to national security – not just through CFIUS in the U.S., but in a growing number of jurisdictions, including in the EU and several Member States.

The search for growth and digitalisation continue to be two powerful drivers of deals and companies remain global in their outlook even at a time of growing protectionism. However, investors are being more selective about where they invest. Do they target all the main economic blocs, the U.S., Europe and Asia – or do they prioritise one or two?

All that underlines profound changes in the global economy. But change is not necessarily bad for M&A deals. Indeed, change can itself be a powerful catalyst for transformational transactions.

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02 *Continued growth underlines U.S. dominance*

U.S. dominance of the global deals market was underlined in the first half, as a string of significant strategic acquisitions saw the value of U.S. transactions grow by 19% to account for some 55% of total global deals.

A surge in big-ticket domestic transactions was a standout feature of the market, lifting the total value of U.S. deals to some USD1.1tn, bucking trends in almost all other markets.

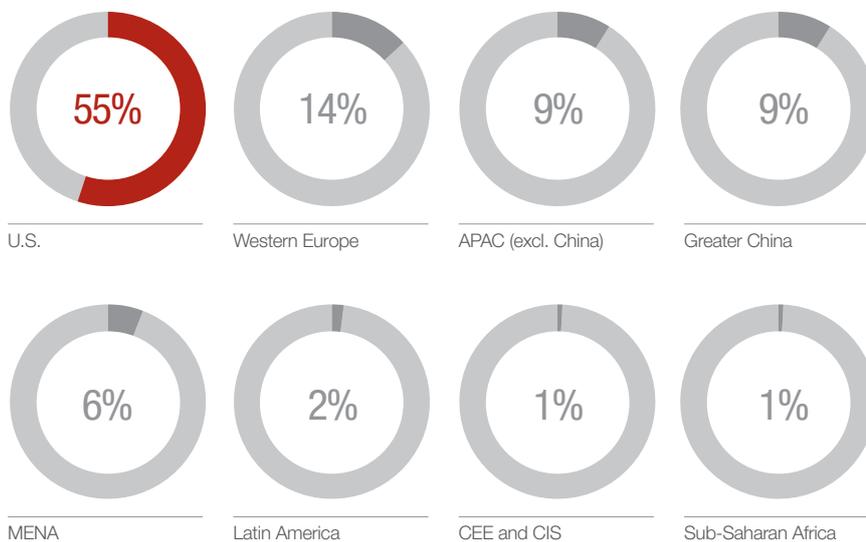
Western Europe continued to see the decline in deal values that became evident in the second half of 2018. Here values fell 57%, with transactions in this region accounting for just 14% of total global deals.

The APAC region, making up 9% of total transactions, fell by 21%, while Greater China was also in retreat, with values falling by 31% to account for 9% of the global market. Values in Eastern Europe and Latin America declined by 36% and 5% respectively.

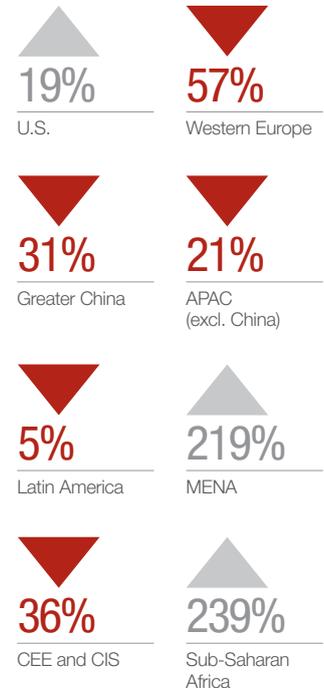
MENA (up by 219%) and Sub-Saharan Africa (up from a low base by 239%) were the only other regions recording growth, in both cases powered by very significant transactions, including the transformational USD69bn Saudi Aramco/SABIC chemicals deal and Total's USD8.8bn acquisition of Anadarko's African assets.

THE STATISTICS

% split of global M&A deals by value



% change from H1 2018



Note: Figures represent deals announced between 1 January 2019 and 30 June 2019

03 *Financial services deals accelerate*

After several years of inactivity, dealmaking has returned with some force to the financial services sector with the value of transactions rising by more than 7% to reach a twelve-year high in the year to date.

Where banking is concerned, this marks a third distinct phase of activity since the financial crisis, which firstly saw many banks disposing of poorly performing assets before then focusing on strengthening capital positions and dealing with a tsunami of regulation.

Many banks are now in much better financial shape and, with the regulatory tide retreating, are once again contemplating acquisitions, although the pace of activity remains relatively slow with deal numbers back to 2013 levels.

Some parts of the industry are still struggling with more fundamental issues. The fate of Germany's second largest institution, Commerzbank, remains in question after an, apparently politically driven, effort to engineer a merger with Deutsche Bank looking to have failed. Reports suggest others may have made tentative approaches, but it remains to be seen if a non-German solution for such an important bank would be seen as acceptable.

Italy's banking industry remains another special case, apparently unable to shake off the troubles of the past, as we have seen with one of the oldest banks, Monte dei Paschi di Siena, only two years after a government bail out.

Other drivers are at play in different parts of the sector. For asset managers, for instance, transparency rules brought in under MIFID II have put huge pressure on firms to cut fees, which, in turn, is encouraging consolidation.

Meanwhile, fintech remains very buoyant with most banks recognising this is an area requiring substantial investment. No longer is it just a case of legacy institutions fighting off disruptive newcomers. Instead there is a growing accent on collaboration between the two, as we've seen with the Barclays venture with start-up, MarketInvoice.

In addition, with some of the original bank disruptors – such as Revolut, Monzo and Atom – reaching maturity, the fintech ecosystem is becoming increasingly rich, especially in the UK and in New York, with further M&A activity likely as it evolves.

“After several years of inactivity, dealmaking has returned with some force to the financial services sector...this marks a third distinct phase of activity since the financial crisis.”

04 *Life of mine – the outlook for the mining industry*

Mining has for so many years been a no-go area for M&A activity, where the focus has been on cutting debt and returning cash, with shareholders putting a virtual ban on M&A. However, there are some interesting developments driving a shift in the market.

This shift is partly down to the firming of commodity prices. Some companies, regaining confidence in making good profits, have seen a significant improvement in share prices as a result.

Iron ore prices seem comfortably settled above the USD100 a tonne level, helped in no small degree by the tragic collapse of Vale's Brumadinho dam and its temporary suspension of production in certain other mines. As the world's biggest supplier of iron ore, predominantly to China, that has pushed up prices further.

Gold prices are not as strong and consolidation is occurring here, as we saw with the USD10bn Newmont/Goldcorp merger, the biggest mining transaction of 2019 so far. We expect to see some further M&A activity led by Australian producers, who are now trading at a healthy premium to their Canadian peers.

There is increased deal activity focused around rare earths and the specialist minerals like lithium and nickel essential to a whole range of technologies, not least batteries, chips and electric vehicles. The bid by Wesfarmers for lithium miner Kidman is a case in point.

It is also bidding for Lynas Corp, the biggest producer of rare earths outside China and a significant prize should China try to lock up the market in rare earth minerals in response to mounting trade tensions, as recent reports suggest.

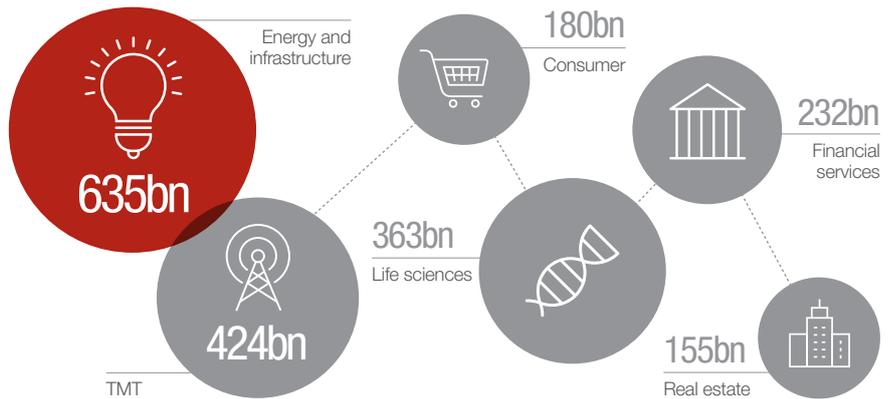
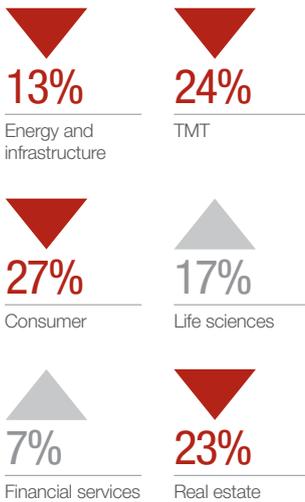
Technology is beginning to disrupt the industry, particularly with the potentially transformational application of blockchain in mining supply chains. But by far the biggest disruptive force for mining is climate change. Its impact will be double-edged, posing an existential threat to coal mining but a fillip for other minerals used to build solar and wind farms (aluminium and iron ore) and those rare earth elements vital to many advanced technologies.

Confidence in the industry is improving and with some investors now urging miners to deploy accumulated cash on value-creating transactions; we expect to see further developments and strong activity in H2.

“By far the biggest disruptive force for mining is climate change. Its impact will be double-edged, posing an existential threat to coal mining but a fillip for other minerals used to build solar and wind farms and those rare earth elements vital to many advanced technologies.”

05 *Top six sectors by value (USD)*

% change from H1 2018



06 *Activist investing – is your board ready?*

The threat of an activist campaign has now become an everyday hazard for listed companies across the world. Yet well-prepared boards can defend against this highly disruptive event and even use it to strengthen their strategic purpose.

Once mostly a feature of U.S. corporate life, activism has now spread to many markets in Europe and Asia and is a threat that shows no sign of abating.

The statistics show that campaigns reached a new high in 2018 and with far greater global reach than ever before. More importantly an increasing number of attacks were focused on transactions, with one study suggesting a third of campaigns were M&A related.

Different dynamics apply in different jurisdictions and, in planning a defence, it is important for boards to understand trends both within their own sectors and in other markets. For instance the UK, now probably the second most popular target for activists, tends to be less litigious than the U.S., with battles fought out through PR or proxy battles rather than in the courts.

Activists are increasingly targeting Japanese companies – often cash-rich and with plenty of non-core businesses that can be sold off. Some continental European jurisdictions offer boards greater protections, not least the Netherlands, but even France has seen an upsurge in activity in important companies such as Pernod Ricard and Lagardère.

With limited regulatory or government intervention, apart from in clear national interest cases, the onus is on boards to prepare their own robust defence, much as they would for a hostile bid. That means keeping strategy under constant review, having board members with an appropriate array of expertise, and maintaining regular contact with current shareholders whose support will be vital.

Most importantly boards should engage with activists, who often have well-articulated cases, presenting clear arguments in support of the current strategy. Stonewalling is not an option; neither is attacking the activists in the media, without a very carefully built plan.

A declining M&A market could expose even more corporate strategic vulnerabilities for activists to exploit. So this is a trend that will only continue to grow, even at an economically uncertain time. Boards need to be ready.

Note: Figures represent deals announced between 1 January 2019 and 30 June 2019

07 *Public M&A shows signs of resilience*

Although activity has declined from last year's record levels, evidence from key jurisdictions suggests that public M&A is remaining resilient supported by a number of factors, not least an increase in private capital being deployed in this market.

Confidence in the U.S. – still the powerhouse for public deals – remains high despite the international and domestic political dramas dominating the headlines. Boardrooms are focusing on achieving growth and realising that this can be achieved fastest through acquisitions – often big strategic deals, innovatively financed and increasingly supported by shareholders.

A dip in share prices at the end of 2018 led to a spate of more opportunistic public deals in both the UK and Germany, but in both markets a standout trend is the growing activity by well-resourced financial investors.

In the UK we have seen an increase in take-privates by PE houses, with the UK public market generally seen as undervalued in comparison to other developed markets. However, a predicted wave of take-private deals in Germany this year has not yet materialised thanks to a recovery in share prices during the Spring. But with big targets relatively scarce, investors appear increasingly

willing to use their accumulated cash to take on larger and more complex deals. Continuing moves by German conglomerates to hive off non-core businesses are also bolstering public activity.

Meanwhile, a series of significant reforms aimed at internationalising China's public markets are already boosting foreign investment in A shares with further liberalisation in the pipeline.

Regulatory complexity remains a challenge, particularly due to the proliferation of national security merger controls. In the U.S. CFIUS reviews are now more frequent and much broader in scope, while in Europe new EU legislation applying from next year will mark the first time a supra-national approach is taken to vetting inbound investment. The German government has become more interventionist on this issue while in the UK proposals for government scrutiny in a much wider range of sectors is under consideration.

Dealmakers must prepare carefully for such challenges and pitch their offers at a level that is hard for target boards to ignore. There is unlikely to be an explosion of public deals in the months ahead, but good reason to believe activity will remain robust.

“Dealmakers must prepare carefully for challenges and pitch their offers at a level that is hard for target boards to ignore.”

In focus: CFIUS – permanent roadblock or just a taller hurdle?

New rules and rapidly evolving policy priorities may raise doubts about whether the U.S. welcomes in-bound investment from certain parts of the world. But with patience and careful planning investors from across the globe (including China) can get U.S. deals done.

In an increasingly protectionist global trading environment – complicated by the U.S./China trade war and the increasing number of countries that have been imposing national security controls on in-bound foreign investment – one player has gathered more than its fair share of headlines.

The Committee on Foreign Investment in the U.S. (**CFIUS**), a relatively undersized but surprisingly powerful committee housed in the U.S. Treasury Department, has been more active than ever vetting proposed transactions, requiring parties to modify their proposed deal terms, and blocking transactions that it has concluded pose unacceptable risk to U.S. national security. Due in part to its increased workload, the timetable for obtaining CFIUS clearance has lengthened considerably. Timing delays, coupled with diminished certainty of obtaining clearance, are creating obvious deal challenges.

In reaction to CFIUS' increased activity and media attention about recently blocked deals, an unknown (and likely increasing) number of parties have been more reluctant in pursuing deals that would necessarily incur CFIUS scrutiny. Others have been voluntarily withdrawing their transactions from consideration once CFIUS' concerns have become apparent.

In addition, the introduction of the Foreign Investment Risk Review Modernization Act of 2018 (**FIRRMA**) reinforced the perception (which is at least partially true) that CFIUS possesses, and will continue to assert, enhanced authority.

Finally, prospective investors from countries that currently have 'difficult' relationships with

the U.S., such as China, have been increasingly – and understandably – skittish about in-bound U.S. investment.

So what does this all mean for dealmakers looking to invest in the U.S.? Can deals still get done? Is the investment of time, money and management resource required to seek and obtain CFIUS clearance worth making? Is the risk posed by the heightened U.S. government scrutiny, the lengthening time period CFIUS review requires, and the generally diminished certainty that CFIUS will ultimately issue clearance worth taking? In most cases, except where national security risks simply cannot be mitigated, the answer is yes.

A brief history

CFIUS was established in 1975 under President Ford, principally to monitor the impact of "foreign" investment in the U.S. and to coordinate related U.S. policy.

Criticised for relative inaction, it began in 1980 (during the Reagan administration) to investigate more foreign investment transactions. During this period, it focused principally on in-bound investment by Japanese firms relating to military products and services.

In reaction to growing concern about Japanese investment during the 1980s, Congress passed the "Exon-Florio" amendment to the Defense Production Act. Exon-Florio gave the President the authority to block proposed in-bound transactions that threatened U.S. national security. It also put in

place the basic process, supplemented by subsequent Treasury Department regulations, that CFIUS still follows. Several changes followed, including a requirement that CFIUS review transactions implicating U.S. national security concerns where the acquirer is controlled by – or acting on behalf of – a foreign government.

CFIUS' focus and level of activity intensified following the 9/11 terrorist attacks. It faced withering scrutiny (much of it unfair) for its handling of a proposed port acquisition by Dubai Ports World in 2006, leading to intensified reviews of in-bound investment, focused in large part (but not exclusively) on acquisitions by Middle Eastern companies and sovereign wealth funds.

More recently, much of CFIUS' most intense activity appears to be focused on Chinese investment. Reflecting this concern, Congress recently passed FIRRMA, which among other things:

- broadens the scope of transactions under CFIUS' review authority;
- mandates the preparation of a report on Chinese investment in the U.S.;
- permits CFIUS to discriminate among foreign investors by country of origin;
- provides for mandatory filings in certain circumstances; and
- somewhat lengthens its review periods.

Following the China theme, all six of the transactions CFIUS has blocked in its history, including three by the Trump Administration since 2017, involved Chinese acquirers, or in one case, no direct Chinese parties but a

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Chinese connection. Most recently, President Trump ordered Beijing Kunlun Tech. Co. Ltd. (a Chinese company) to divest Grindr LLC, an online dating site, due to concern about non-U.S. persons’ access to personal information about U.S. persons. Recent public statements by Treasury Department officials, as well as our own experience, reinforce the view that China is a major CFIUS priority for now, and will be for the foreseeable future.

How does the process work now?

The Pilot Program for Short-Form Mandatory Declarations

The FIRRMA legislation, for the first time, introduces mandatory reporting of proposed transactions in certain circumstances and it is here where its impact is being felt most acutely. Previously, the process was entirely voluntary.

Those investors going down the mandatory reporting route are offered the chance to use a short-form filing, requiring less information and with the “promise” that the investigation will be squeezed into a reduced 30-day review period.

However, this promise is often unkept. Frequently, CFIUS has been advising parties who have made short-form filings under the new pilot program mandate to nevertheless make a full long-form voluntary filing, which is subject to the now-longer review and investigation period. As a result, rather than save time and money by relying on the short-form filing, these costs are added onto the costs of submitting the long-form filing and ushering it through to completion.

Of course, where approval is granted within 30 days, everyone is happy. However, parties to deals that raise potentially significant national security issues would be wise to consider foregoing the 30-day abbreviated review and move straight to the full review and investigation process.

Long form filings

Parties that forego or do not qualify for the mandatory declaration, will submit a full joint voluntary notice (**JVN**), which is subject to a 45-day review period, potentially followed by a 45-day (and up to 60-day) investigation period. Following the investigation period, if a referral to the President is made, the President has 15 days to clear or block the underlying transaction.

These time periods are deceptive, because the entire process is preceded by an informal consultation with CFIUS, during which CFIUS reviews and comments on an initial draft submitted by the parties. CFIUS also often takes several weeks (due primarily to its own internal workload management challenges) to review drafts and begin the various applicable timetables.

As a result, transaction parties contemplating making a filing should assume a reasonable worst case of up to six months or more from start to finish (which includes time for preparing of draft filing, CFIUS’ review of the draft filing, addressing CFIUS comments, submitting final filing, initial lag time for CFIUS to “start the clock” after receiving the final filing, and then progressing through the course of the review and investigation periods).

In addition, it is not uncommon for CFIUS to ask parties to withdraw and refile their JVN, often because CFIUS needs more time to determine if any unresolved issue effecting U.S. national security exists.

How are dealmakers approaching CFIUS now?

Most dealmakers are now well aware of the potential challenges CFIUS can pose. There are, however, some nuances in how various categories of dealmakers approach the process.

Strategic buyers, especially those with an existing or aspirational U.S. presence, are prone to file even where it could be argued that filing is not warranted (such as where there does not appear to be significant national security risk at issue). The rationale for this approach is often the perceived value of establishing and/or maintaining a transparent relationship of trust with the U.S. government, particularly where future transactions are contemplated. Where investors (or their targets) have significant U.S. government contracts, they also tend to be especially focused on preserving relationships with the relevant government counterparties.

Private equity buyers' approaches will vary considerably. In an auction, PE bidders will often seek to justify not filing – or not condition

their bid on a filing – in order to avoid making their bid comparatively less attractive relative to bids from U.S. bidders or other non-U.S. bidders who know less or care less about U.S. deal practice or present less CFIUS risk. This approach has become somewhat obsolete with the passage of FIRRMA and the possibility that a filing would be mandatory regardless of the parties' preferences. However, for transactions where the new pilot program requiring a filing is not applicable, the "CFIUS question" is often the subject of prolonged discussions about auction tactics and strategy. Repeat buyers will, like strategic buyers, also be interested in ensuring that CFIUS perceives them to be a trusted player.

Funds with complex ownership structures face particular challenges. The CFIUS process requires that parties disclose details about their significant shareholders and management structure, and be prepared to answer additional questions (typically within 72 hours). For some, ultimate ownership is evolving, and individual owners may demand that their holdings and roles be kept confidential.

Finally, investors with significant links to sensitive jurisdictions are – and should be – cautious. For example, at this point in the

cycle of the U.S./China relationship, Chinese investors will face an uphill battle in acquiring businesses involving critical technology or infrastructure, significant intellectual property, or any access to U.S. persons' personal data. Such deals would not be impossible, however, if the investors were willing to completely ring-fence the U.S. business or assets and CFIUS could be made comfortable with the arrangements. However, acquisitions of non-critical assets or technologies with no apparent national security connection (including physical proximity to sensitive U.S. government locations), should be and are in fact quite possible and doable.

This last example illuminates an important point. It is abundantly clear of course that the U.S. government is sincerely focused on protecting U.S. national security. And we know from our dealings with CFIUS and its stakeholders that the professionals who work there take this responsibility seriously. On the other hand, these individuals (and the U.S. government more broadly) are also to varying degrees committed to ensuring that foreign investment into the U.S. continues, albeit safely and appropriately. Non-U.S. investment is critical to the U.S. economy and will continue to be so.



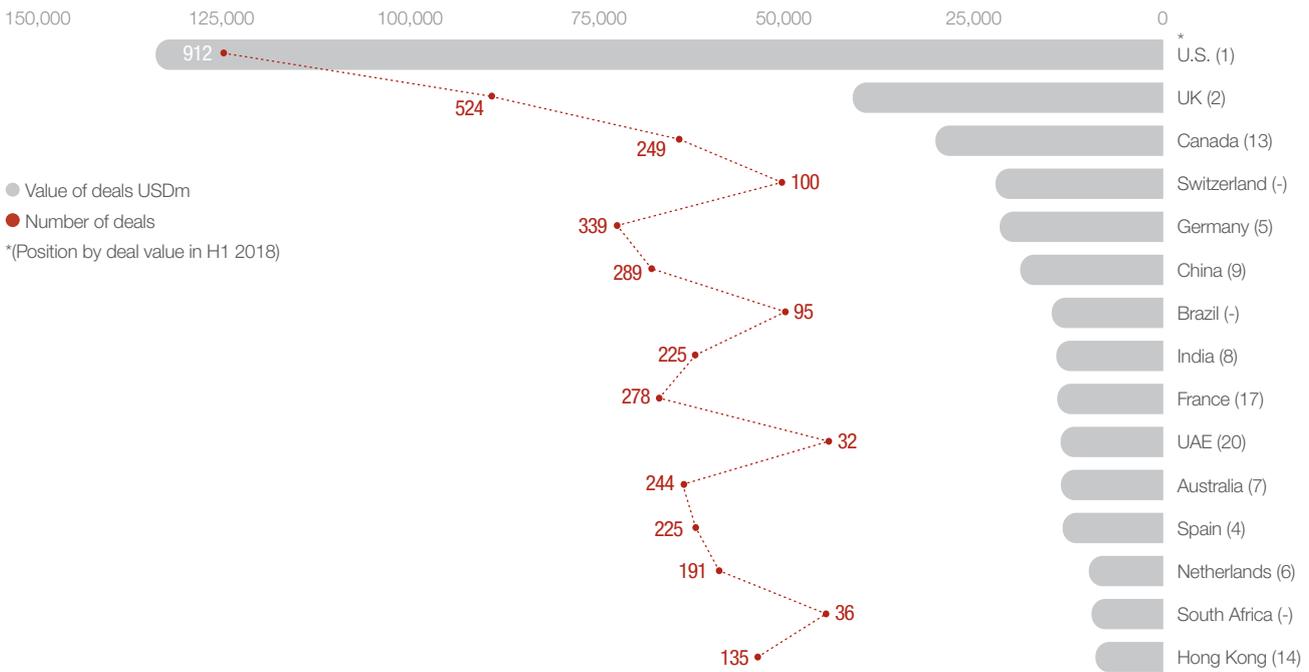
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Global deal flows

Inbound target markets



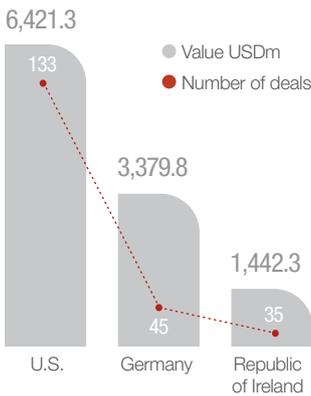
● Value of deals USDm
● Number of deals
*(Position by deal value in H1 2018)

01 UK companies target known markets

UK number of outbound deals

578

UK top 3 target nations (2019 H1)



Despite declining investment activity at home, UK companies continue to do a significant number of outbound deals, with the U.S. and Germany highest on the list of target markets.

Measured by number of deals, the UK ranked second only to the U.S. as the biggest overseas investor with 578 transactions so far this year.

Mid-sized, bolt-on deals appear to predominate rather than big, strategic transactions and not surprisingly they show a preference for familiar target markets. That makes economies offering good growth, access to sophisticated technologies and an accommodating approach to UK investment most attractive.

A weak pound may, slightly perversely, be another motivating factor to look overseas as many UK listed companies' share prices are being bolstered by non-sterling earnings. Lack of clarity around the UK's future trading relations with the EU and other economies

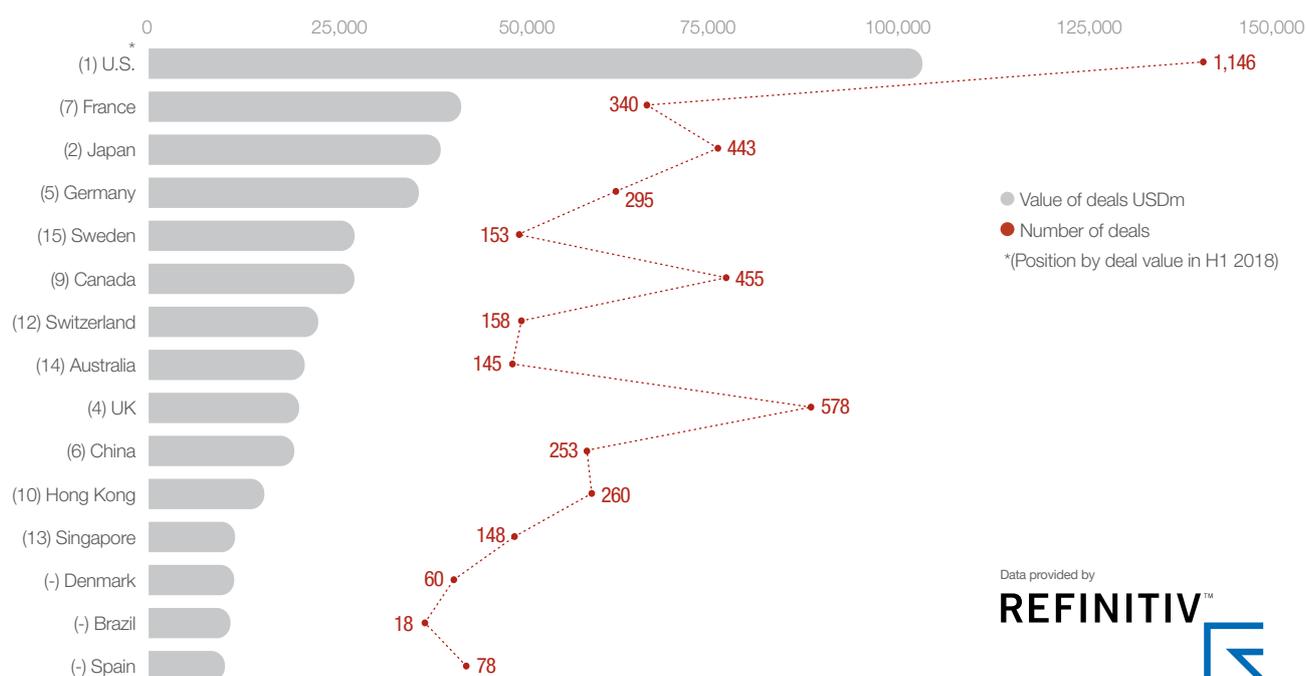
post-Brexit is clearly not holding up M&A that can be done without trade agreements being in place.

For many investors into the UK, Brexit is an uncertainty that they are learning to live with and, for long-term investors such as pension and sovereign wealth funds, one they can look beyond, while taking immediate advantage of lower asset prices.

However, we have seen growing anxiety among Chinese investors around the increasing politicisation of trade policy.

Most of that is focused on the U.S., of course. But, as new foreign direct investment regimes are introduced, including in the EU and the UK, worries that China may be locked out of key markets are becoming more widespread. In some key sectors, like semi-conductors, that could see companies choosing progressively to develop capabilities at home rather than investing in them overseas.

Outbound acquirers



02 France's giants continue search for global growth

France shot to second place in the league table of cross-border acquirer nations in the first half of 2019, as some of its largest companies stepped up their global search for growth.

Measured by deal value, France trailed only the U.S. in outbound activity, its companies executing a series of bold, strategic transactions despite current political and economic uncertainties.

Total's agreement to support Occidental's bid for Anadarko by buying the latter's African oil and gas assets for USD8.8bn, exemplifies the mood of many of France's heaviest-hitting companies – a willingness to quickly seize transformational opportunities as they emerge.

Disruption and consolidation in the auto and media sectors also drove deals. Renault is considering a USD33bn merger proposal from Fiat Chrysler, while, on a smaller scale, auto-parts maker Faurecia has acquired Clarion, the Japanese maker of car navigation systems. Standout media deals included the USD4.4bn acquisition of U.S. digital marketing group, Epsilon, by Publicis and the EUR1bn takeover of M7, the Benelux and Central European pay-TV operator, by Vivendi's Canal+.

There were some major setbacks, not least the European Commission's landmark decision to block the Siemens/Alstom rail merger – leading to calls in France and Germany for new EU antitrust rules allowing for the creation of European Champions.

Investors remain relatively calm about the geo-political outlook, although there are worries about the China/U.S. trade war and rising energy prices.

Brexit has even receded as a concern and, with sterling weak, some are swooping on cheaper UK assets. Airport operator Vinci, for instance, spent GBP2.9bn to win control of Gatwick airport.

While there is concern over whether France and Germany can settle destabilising differences over the future leadership of the EU, there is no sign, yet, of companies delaying planned transactions in the face of such uncertainties.

Note: Figures represent deals announced between 1 January 2019 and 30 June 2019

“There are good reasons to believe there will still be many opportunities, within the region and globally, for investors who remain agile and ambitious.”

03 *A turbulent but active year in Asia Pacific*

While many commentators have predicted a downturn in Asia Pacific M&A activity this year, and the figures show a 9% drop in activity in the first half of the year, there are good reasons to believe there will still be many opportunities, within the region and globally, for investors who remain agile and ambitious.

Given political and regulatory uncertainty, there is no doubt the market will be challenging, but we do not anticipate a massive decline in transactions, and for several reasons.

The U.S./China trade war is having a clear impact not least on Chinese investment in the U.S. – down a staggering 80% in 2018.

But, overall, China outbound activity has remained robust, with investors targeting more friendly markets in parts of Europe, Southeast Asia and “Belt and Road” countries. In the other direction, Beijing’s new Foreign Investment Law, coming into effect in 2020, should also spur inbound transactions into China.

With Chinese companies struggling to make headway in the U.S. that has also opened the way for other Asian investors to seize opportunities, notably increasingly ambitious and well-financed Japanese investors. Japan itself is also proving an attractive hunting

ground for inbound investors, as Japan undertakes large-scale restructuring and divestment efforts in response to a more active shareholder environment.

Southeast Asian markets continue to draw in foreign investment and a number of companies in key markets are now pursuing outbound opportunities as they grow.

Three types of disruption – regulatory, financial and technological – will pose challenges but also give rise to opportunities. Greater antitrust and other regulatory interventions will make completing deals more challenging, for sure. But the emergence of alternative funding sources – such as the provision of unregulated debt from credit funds often with liquidity provided by pension and sovereign wealth funds – means additional financing options are opening up.

The big tech companies continue to expand their platforms in the region, but increasingly we are seeing traditional industry players investing heavily in digitalisation, often through acquisitions or joint ventures.

Overall it adds up to a much more dynamic picture than some forecasters suggest. For that reason, we expect activity to remain buoyant with plenty of opportunities for investors who hold their nerve and stay nimble.



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