

Regional developments in M&A

Corporate analysis: The 2017 Lex Mundi Global Seminar on Cross-Border Transactions was held on 2 November 2017 in London, United Kingdom. The seminar brought together legal practitioners, financial institutions and advisers, commentators and market participants in the cross-border M&A sphere to discuss key trends and developments in cross-border transactions. This article summarises the discussions and conclusions in relation to regional developments in M&A which were considered in the second session of the conference.

France

There has been a real change in the business community further to the election of Emmanuel Macron in 2017 and the launch of his proposed reforms. These reforms, which are viewed as business friendly, include:

- employment law reforms seeking to limit the rights of employees, eg Macron plans to cap the amount of indemnity payments made to employees when they are made redundant, and
- tax reforms, such as:
 - the abolition of the wealth tax which was expected to be replaced on 1 January 2018 by a tax on real estate assets owned by individuals, thus ending the taxation of individuals in respect of all their financial assets
 - imposing a flat tax of 30% on all investment income (dividends, interest, capital gains) and
 - a proposed decrease in the corporation tax rate from 33.33% to 25% until 2022.

In 2017, France has seen the unemployment rate decrease and growth increase. There has also been a shift in the political landscape from six months ago, when the fear was that the presidential elections might produce an uncertain outcome with possible negative effects for the business environment. With the election of Emmanuel Macron, there is a view that France has elected a pro-business politician. An urgency was also expressed for Macron in France and Angela Merkel in Germany to succeed politically, noting that if they were to fail over the next five years, further political instability could follow.

France is currently a very seller friendly market with deal terms influenced by Private Equity (PE). Key factors in concluding successful deals in France centre around certainty of closing. In deal terms practitioners are seeing an absence of Material Adverse Change (MAC) clauses and a lot of locked box structures. First price is also important in deals. Warranty and indemnity (W&I) insurance has, over the last two years, become very popular across industries.

In terms of industry focus, France has seen a lot of consumer, retail and real estate deals. There have also been some pharmaceutical deals. One specific deal highlighted as pushing deal activity in France into a retail focus was the \$US 13 billion LVMH offer to acquire Christian Dior.

Other trends include:

- continued investment from the USA

- a high number of intra-European deals, and
- a clear decline in investment from China

The decline in Chinese investment is seen as partly — but not solely — due to the new set of investment guidelines relating to overseas investments by Chinese companies published by China's State Council in August 2017 (the Chinese Guidelines). These guidelines are aimed at providing official clarity by classifying overseas investments into three main categories:

- encouraged investments
- restricted investments, and
- prohibited investments

Countries across Europe and elsewhere have passed legislation against inbound investment in particular, from China. These restrictions have made certainty of closing a clear driving factor in M&A deals, ie in the current climate, a bidder offering a higher price to other interested parties on a proposed acquisition may fail, due to concerns as to whether that bidder will be able to fund or close the deal, eg due to protectionist restrictions of a particular country affecting the relevant bidder.

It could be beneficial for a prospective buyer to conduct a full anti-trust analysis prior to embarking on a deal, ie a prospective seller would be keen to see that a potential buyer had carried out this exercise, as a means of assuring the seller of the likelihood of that deal completing.

Germany

The German M&A market is a seller's market with strong cross border investment. Of particular note is the prevalence of locked-box structures. Even towards the end of 2017, some sellers were still able to reference balance sheets as at the end of 2016 as the locked-box date. Competition for assets is very strong forcing an increasing number of PE bidders to provide full equity backstop commitments to succeed in auctions. Deal drivers are structural changes in regulated sectors such as energy, telecommunications and financial services as well as the challenges of digitalisation for industry 4.0. Deal enablers are cheap financing and the proliferation of debt funds also offering structural flexibility. W&I insurance is widely used on the buy-side with a trend for highly tailored solutions for special issues, such as tax. As management is key in buy out transactions, strong managements can command less onerous leaver packages. The market has noticed an increase in minority investments by financial sponsors. Shareholder activists have also run a variety of campaigns and are there to stay in Germany. Although some big transactions have taken place, such as the takeover of STADA, the acquisition of Ista and the Linde/ Praxair merger, Germany is dominated by mid market deals.

USA

The three main risks noted as holding back mega deals in the US market are:

- CFIUS risk (perception of national protectionism especially regarding China inbound deals),
- tax risk, and
- anti-trust risk

The main deal of the year noted was the \$US 85.4 billion AT&T-Time Warner merger which is currently held up due to anti-trust concerns.

The US market's current expectation is that new laws implementing substantial tax cuts will be passed by the Trump administration and the Republicans in Congress. It is believed that businesses are waiting for these laws to be implemented, ie businesses are delaying launching certain M&A transactions now, in the belief that taxes will decrease in the near future and that more optimal structures may be available as a result of tax reform thus making any such proposed deals potentially more attractive at a later date.

The Trump administration blocked one deal this year relating to the purchase of a US semiconductor company by a Chinese investment firm, citing national security concerns. The deal related to a proposal by Canyon Bridge Capital, a fund backed by China Venture Capital, to acquire Lattice Semiconductor, a US chipmaker. The deal was blocked out of fears that through exercising control of Lattice Semiconductor Corporation, Canyon Bridge Capital might take action that threatens to impair the national security of the United States.

Where deals are for less than \$US 2 billion no practical anti-trust risk is believed to apply. For 2017 to date, the US market was viewed as being robust despite the size of deals being lower than those in previous years.

Amazon's \$US 13.7 billion purchase of Whole Foods in June 2017 indicates a strategic move by online retailers into more bricks and mortar assets. Amazon was noted as one of the biggest spenders on research and development (R&D).

The proposed deal by CVS Health to acquire Aetna (a health insurance company) for \$US 66 billion was viewed as a means of defending these companies against a potential move by Amazon into the pharmaceutical industry.

The US market is a super-seller friendly environment at present. Public deal terms are moving more and more into the PE sphere, to the point where practitioners are seeing deal terms almost more akin to those when operating in the public markets as opposed to in the private sphere. The use of W&I insurance, especially in deals involving private equity market participants, is also increasingly prevalent where previously it was not part of the conversation on deals.

South America

Trends in the US and European M&A markets are not necessarily reflected in the South American M&A market, which has been strongly influenced by the impact of anti-corruption investigations. Traditional Brazilian tycoons have been excluded from participating in new tenders and forced to divest their assets. This has led to a lot of good assets becoming available on the market, ie an increase in distressed sellers as opposed to distressed assets in a pro-buyer market, creating space for new investors.

There has been a great deal of investment by Chinese investors in infrastructure and energy assets across the continent and, in the South American market, there is yet to be the same type of scrutiny as in Europe and the USA in relation to investments in these types of assets by overseas investors. There are different attitudes evident between those foreign investors who are used to and familiar with the region and newcomers. Within this market, the former are more comfortable and used to navigating the waters taking advantage of the opportunities available while the latter are still delaying action on a more 'wait & see' approach.

The finance market is also in a transformational moment, with the government backed banks significantly reducing their role as main lenders as the private sector seeks to expand, so that competition for structuring and financing projects will occur on a more level playing field.

There is a need to adopt various mitigation solutions to counter increasing risks, eg of the anti-trust variety, of investing in South America. Early identification of these risks is seen as key, allowing for such risks to be ring fenced or somehow mitigated. The importance of anti-trust rules, especially in Brazil is also a key factor. The local authorities, who are quite active, have shown 'sharp teeth' in some of their latest decisions and scrutiny of the markets.

Dealing with tax matters is always a big challenge, particularly in Brazil, and despite the fact deal documentation would generally include a comprehensive tax indemnity special attention is required to properly understand and manage these types of liabilities. Thus reliance on local advisors to bridge cultural -and legal- differences is paramount so as to be able to assess the customary practices without raising unnecessary alarm.

United Kingdom

The UK market is seen as bifurcated. UK domestic M&A has been severely affected by Brexit, with UK domestic investors waiting to see how Brexit progresses before investing.

In the high end segment of the market there has been no real effect. Activity in the USA on the other hand has had more effect on cross-border M&A. US anti-trust laws, eg CFIUS, have had a larger role in deals across Europe. There has also been an interest shown in looking more closely at the assets of non-EU buyers.

There has been an increased focus on looking at Foreign Corrupt Practices Act (FCPA) concepts in deals as these have been assuming a more extra-territorial scope. A lot of time on deals is seen as being spent dealing with compliance and anti-corruption issues.

A significant number of US companies currently hold numerous assets outside of the USA. Many of these companies are waiting to see whether the proposed changes in tax laws in the US will result in a tax amnesty allowing some of these assets to be repatriated.

In private M&A deals the concept of certain funds has been borrowed from public M&A deals, eg it is common to see fully documented certain funds powers of attorney in share purchase agreements. Other trends to note in M&A deals include:

- that equity commitment letters have effectively become guarantees
- that sellers are asking prospective buyers to provide non-refundable deposits to deal with regulatory risks, eg the risk of deals being blocked by anti-trust authorities
- the use of locked-box mechanisms
- higher prices being offered by prospective buyers if the seller offers traditional representations and warranties in the deal documentation, and
- low caps for seller deal liability, ie in the range of 30-50% of the deal consideration