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Into the unknown: European M&A Outlook 2016

A study of European M&A activity

November 2016

In cooperation with:



MERGERMARKET

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Foreword



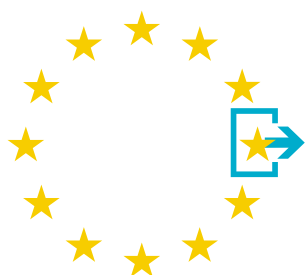
Stefan
Brunnschweiler
Global Head of
CMS Corporate/
M&A Group

Welcome to the fourth edition of CMS' European M&A Outlook, in association with Mergermarket

The year so far has been dominated by the UK's decision to leave the European Union. On the one hand, the uncertainty created is tempering dealmaking in some quarters as firms look to wait and see what the outcome will be. However, elsewhere, some are seeing the Leave vote as an opportunity, as the unsteadiness sweeping markets provides a platform for savvy firms to take advantage.

With this in mind, our survey provides a unique contrast of the expectations of European M&A pre- and post-Brexit, as corporates and private equity firms wrestle with its consequences for their businesses and dealmaking prospects.

Key findings from the research include:



Brexit hits expectations.

Two-thirds of respondents believe that European M&A will fall when asked in the aftermath of the Brexit vote, compared with just 18% in our survey earlier in the year. Dealmakers are wary of the uncertainty, which could potentially pause activity both in the UK and beyond as companies wait for the dust to settle.



Bargain hunters.

An upside of the Brexit vote for buyers is its effect on the price of assets. Post-Brexit, 54% say that undervalued targets will be one of the greatest buy-side drivers, compared with 39% before the vote. Among corporates and private equity firms considering acquisitions, favourable prices are seen as a key motivator by almost nine in ten.



Cross-border drive.

While European dealmakers may have hit the brakes, the sentiment for international buyers remains strong. Almost four-fifths anticipate more cross-border M&A into Europe next year, while 61% think the value of these deals will increase. Buyers from North America and China in particular will look to snap up assets to fuel overseas growth.

Market commentary

Fight or flight?

Brexit has thrown a spanner into the works regarding European dealmaking — but are there reasons to be cheerful? The *New York Times*' Deal Professor, Steven Davidoff Solomon, thinks so



Steven Davidoff Solomon
The *New York Times*'
Deal Professor

Former British Prime Minister Winston Churchill proposed at the end of World War II that there must be built “a kind of United States of Europe”. Alas, the grand 20th century European integration project that is the European Union (EU) has at a minimum hit a speed bump, and is certainly on pause. In turn, this has had a knock-on effect for M&A and investment.

Takeovers thrive on confidence. When CEOs are enthusiastic about the economic and regulatory environment, deals abound. Volatility and uncertainty are their enemy, as CEOs prefer to seek the safety of the sidelines during such times, instead focusing on their core businesses. Brexit spells a particular form of disruption as the uncertainty of its actual form and timing preoccupy the executive suite. There is a real possibility that Brexit — particularly with messages being sent from

the governing Conservative Party's 2016 Conference — will mean Britain setting limits on immigration and trade with the continent.

But there is still the alternative possibility that Brexit will be a blip, fizzling out as the United Kingdom faces up to reality without the EU. There are other middle-of-the-road possibilities. In light of the different Brexit paths and the different impacts each one might have, who can blame executives for taking pause as reality justifies pessimism?

Roaring back

Churchill also said, however, that “A pessimist sees difficulty in every opportunity; an optimist sees the opportunity in every difficulty”. This is doubly apt when considering both the difficulties surrounding Brexit as well as the strife across Europe generally, creating room for investments. In a zero interest rate world, the hunger for acquisitions is likely to still be in plentiful supply as companies search for ways to increase growth and returns. Private equity firms with large stores of dry powder continue to look for elusive bargains in the turmoil, for example. These buyout houses specialise in taking risk, and so will supplant corporate CEOs who are adopting more of a “wait and see” approach.

It will not just be private equity. As Chinese acquirers seek outside acquisitions to hedge a renminbi devaluation, there will continue to be robust support for takeovers. Americans will also seek to establish greater beachheads as they too flee a low interest rate environment. The result is likely to be a steady undercurrent of takeovers despite the measured gloom.

Consolidation consolation

We are also in a world of oligopoly, as industries consolidate into a smaller number of dominant companies. Nowhere is this reflected more than in technology acquisitions – now a fact of corporate life – as firms seek to build out and grow their own technology. Brexit could create opportunities for technology companies to sidestep an increasingly active competition authority, focusing efforts on a perhaps more relaxed Britain.

The near-term uncertainty also highlights hedging activity for what may come. Even a “Brexit-lite” will likely mean some limitations on the flow of people and goods, but also shifts and reallocation of business towards the continent and Ireland. There will no doubt be many opportunities for takeovers that take advantage of such shifts.

And it will perhaps mean a longer-term downturn for the UK as business does shift outward. However, this is unknowable, and while it may be conventional wisdom it is hard to see London – with its huge advantages of language, infrastructure and diversity – going down without a fight.

Brighter horizons

All is not lost even for the pessimists. As the longer-term uncertainty fades, takeovers will return. M&A is cyclical, but even today the low peaks mean sustained activity in the trillions per year. The takeover business is also adaptable. If and when Brexit is negotiated, it will set new rules. Dealmakers will then know how to work around and within those boundaries. Adapting to new environments and working around set rules is nothing that business people and their advisers haven’t dealt with before.

In the meantime, Brexit is a world-changing event that deserves sobriety and tempered assessment of everything, let alone takeovers. However, the real question will be whether this sentiment holds as Brexit takes shape and form.

Brexit briefing

Need to know: Sarah Grenfell and Graeme Young on Brexit's M&A impact



**Sarah
Grenfell**
Partner,
CMS London



**Graeme
Young**
Partner,
CMS London

Will parties be able to terminate contracts as a result of Brexit?

Some parties had the foresight to include Brexit clauses in their contracts; however, only clauses which specify a right to terminate "upon a majority leave vote" (or something similarly precise) in the June 2016 referendum will be capable of being exercised at this time. If a contract merely stipulates the right to terminate in the event of Brexit, as this has not yet occurred, a party wishing to rely upon this clause could be waiting for a number of years.

Seeking to avoid contractual obligations post-Brexit is a thin path to tread, however, and companies shouldn't rely solely on this potential way out. For example, English law has no independent concept of "force majeure", meaning that these types of clauses would have to be looked at on a case-by-case basis to consider whether Brexit constitutes such an incident. In any case, the judicial authority is clear on the point that the force majeure event must render the performance of the contract physically or legally impossible, not just made more difficult or unprofitable. Similarly, the doctrine of frustration – in which firms can avoid contractual obligations when a "frustrating" event occurs – only applies if the event renders the contract physically or commercially impossible to fulfil, or transforms the contractual obligations into something that is radically different from that which was agreed by the parties when the contract was entered into.

Hardship clauses may also have been sought to protect against a material shift in the value of sterling, the available pool of appropriately qualified resources to perform a party's obligations, or a significant change in the cost of raw materials or energy. While firms may be able to renegotiate parts of the arrangement on the back of them, care will be needed to ensure they are enforceable. It may not be, for example, without some additional mechanism dealing with the consequences of the parties failing to reach agreement. Material adverse change (MAC) clauses, while also providing a degree of insurance, will also depend on the specific wording of the contract and whether Brexit has caused an actual adverse change rather than the risk of adverse change.

Will UK court judgments be easily recognised and enforced within Europe post-Brexit?

As the UK's withdrawal has not yet been negotiated, it is still unclear to what extent the new regime could complicate recognition and enforcement of English court judgments in EU member states (and vice-versa). This may cause anxiety for parties expecting to be affected by these changes.

The UK will remain subject to the Recast Brussels Regulation until it withdraws from the EU, allowing for the recognition and enforcement of judgments from the courts of one EU member state across all others. Thereafter, there are several options that may be open to the UK, including becoming a signatory to the Lugano Convention (which is similar to the Regulation which preceded the Recast Brussels Regulation) and/or acceding to The Hague Convention on Choice of Court Agreements.

How will Brexit affect the choice of law clauses in contracts, in particular those subject to English Law?

English courts currently apply the Rome I and Rome II regulations to determine the law governing a dispute. Broadly speaking, these regulations give effect to the parties' choice of law (subject to certain exceptions) where expressly stated, or provide rules to ascertain the governing law where this has not been agreed. Post-Brexit, the UK may decide to continue to apply these rules, or revert back to similar rules that were in place beforehand. Importantly, EU member states will be required to apply these regulations, and therefore should recognise choice of law clauses in contracts, which specify the governing law as the laws of England and Wales.

What other regulatory changes could affect M&A?

Merger clearance could become a complicating factor for M&A. The EU currently operates a "one stop-shop" merger control regime, which avoids multiple filings having to be made in individual EU jurisdictions.

Post-Brexit, greater thought will need to be given to filing deals separately with the UK's Competition and Markets Authority (CMA). The UK currently operates a "voluntary" merger filing regime meaning there is no obligation to notify for prior clearance. However, the CMA has significant powers to suspend and ultimately unscramble completed deals, and foreign clients often find its approach more interventionist than in many other jurisdictions.

Are there any strategies parties can implement to increase M&A certainty? What steps should parties take in the long-term?

As it could instigate many business-impacting changes in legislation, it may be advisable to include a mechanism to resolve issues arising where legislative change could have a material impact. Some may prefer to insert arbitration clauses into their contracts, since Brexit will not affect the enforceability of foreign arbitral awards.

First, consider the degree of exposure your contracts might have to Brexit's impact. For those already involved in a dispute with a party from an EU member state (or a dispute which may result in judgment requiring enforcement in an EU member state), it is likely that the dispute will be resolved and/or judgment enforced before Brexit takes effect. With this it should be "business as usual". However, if you are involved in proceedings or contemplating proceedings which may be affected by Brexit, it is important to keep the issues we have discussed under review. In the short-term, you may also wish to enforce any judgments you have obtained without delay, as well as review existing contracts to identify contracts or clauses which may be affected by Brexit.





Methodology

In the second quarter of 2016, Mergermarket surveyed senior executives from 170 corporates and 60 private equity firms based in Europe about their expectations for European M&A activity over the next 12 months. We then resurveyed the same participants in the wake of the Brexit vote in July and August, which are the main results presented in this publication. Results from the initial survey are only shown to highlight relevant contrasts to the resurvey.

All respondents have been involved in an M&A deal in the past two years. All responses are anonymous and the results are presented in aggregate.

Chapter one

Breaking bad?

Our survey investigates the M&A environment and executive expectation in a post-Brexit Europe. And the results show strong swings in sentiment

Top findings

66%

of respondents feel M&A in Europe will decline

90%

are less positive about levels of European M&A activity than they were last year

54%

believe undervalued targets will be the main driver of buy-side M&A

65%

feel that distress will be the greatest sell-side driver

79%

state that cross-border deals into Europe from non-European acquirers will increase

Global macroeconomic headwinds, such as the slowdown in China and the depression in commodity prices, alongside political upheaval characterised by the Brexit vote and a heated election campaign in the US have unsettled executives and adversely affected the European M&A market. In particular, these factors have weakened appetite for larger M&A deals in Europe in the first nine months of 2016. According to Mergermarket data, deal volume for the first nine months of 2016 fell by 3% to 4,849 deals compared with the same timeframe in 2015, and combined deal value dropped 12% over the same period to €476.3bn.

The UK has been particularly affected, with combined deal value dropping 52% on the first three quarters of 2015, presumably due

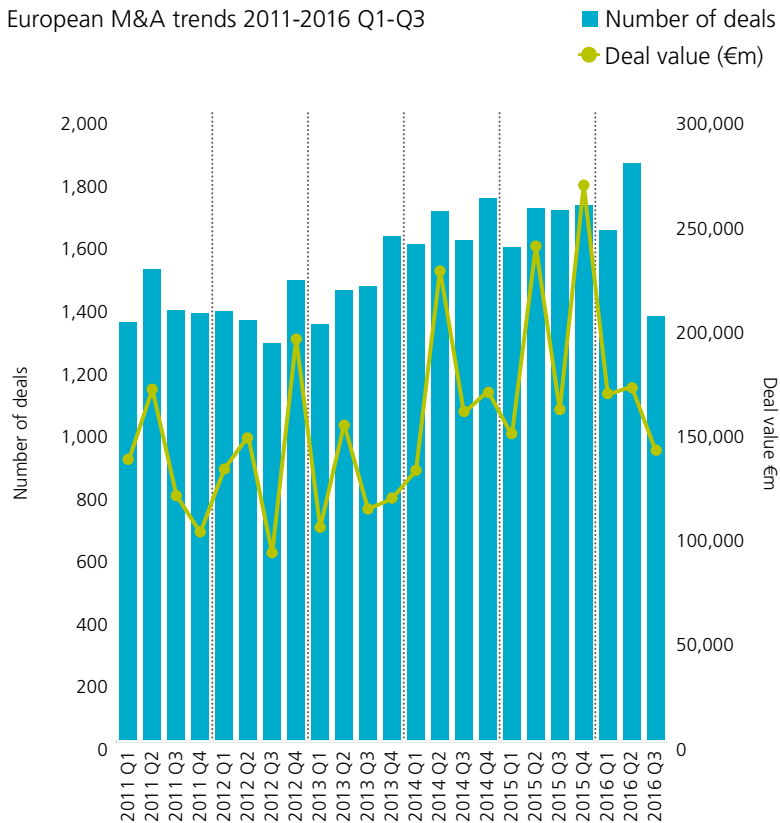
to the uncertainty surrounding the outcome of June's referendum.

The Brexit effect

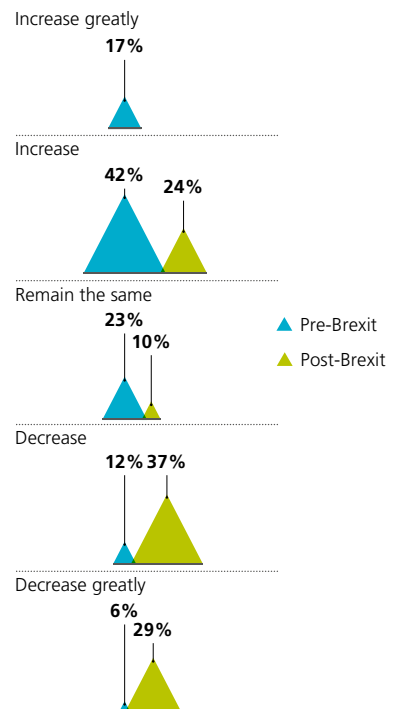
While value is down, the UK still has the highest volume of deals in Europe, with 988 in the first nine months of 2016, and the highest total value, at €102.9bn. Yet the leave vote sent tremors across the continent – and our survey underlines just how hard it has hit market sentiment. In our original survey ahead of the referendum, 59% of respondents expected European M&A activity to increase over the next 12 months. However, in a revised poll taken after the referendum, the proportion expecting an increase in M&A activity has fallen to just 24%. In the resurvey, 90% of respondents say that they feel less positive than in 2015, with no one saying that they feel more positive. This compares with 45% being more positive and 23% less positive in the first survey.

"After the Brexit vote, I can only say that M&A activity will get worse," says the managing partner of a Belgium-based private equity (PE) firm. "Brexit has put Europe in trouble and the future is very uncertain. No decisions can be easily made, especially when it comes to acquisitions, so there will be a significant reduction."

European M&A trends 2011-2016 Q1-Q3

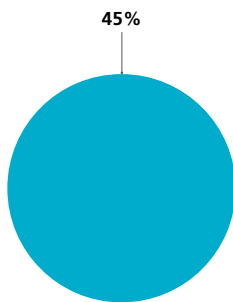


What do you expect to happen to the level of European M&A activity over the next 12 months?



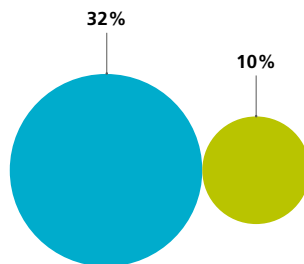
Are you more positive about the level of European M&A activity than last year?

More positive than last year

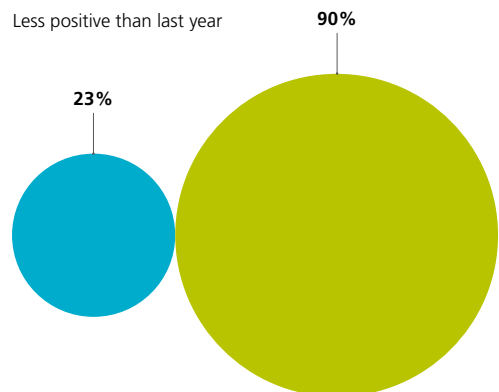


● Pre-Brexit
● Post-Brexit

The same as last year



Less positive than last year



With no consensus from the British government about how it will proceed with Brexit negotiations, and the future of trade deals with the EU and the rest of the world still the subject of speculation, uncertainty abounds. This may well have a dampening effect on the deal market – both for the UK and Europe as a whole.

Best buys

Despite the uncertainty, a weakened pound, undervalued assets and corporates outside of Europe with a voracious appetite for M&A should keep the market buoyant – though it is unlikely to hit the record-breaking heights of the past two years.

The strength of the dollar against the euro and sterling is likely to attract transatlantic deals. And while much was made of the pound's recovery in August, its current level is still well below rates seen in the past ten years, including the slump during the tail end of the financial crisis.

Between the two surveys, the proportion of respondents expecting currency weakness to be the main driver of demand rose by four percentage points, to 18%, perhaps as falls in sterling and, indeed, the euro have occurred in the wake of the referendum.

"I still think M&A will increase, especially in the UK, as a weak currency will make the assets in the UK more attractive and, in uncertain times, M&A is the right solution

for growth," says the managing director of a French PE firm.

Over half of respondents (54%) now expect undervalued targets to be the main buy-side driver of European M&A, partly due to economic and political headwinds pushing down valuations. In our pre-Brexit survey, cash-rich corporate acquirers were expected to be the greatest buy-side driver (55%), but following the referendum only 37% now say that this will be the main factor behind demand.

Distress drives deals

The leading sell-side driver of M&A activity is likely to be distress, according to 65% of respondents, up significantly from the pre-Brexit survey level of 43%. The second biggest sell-side driver is expected to be non-core asset sales (49%).

Some deals led by these factors are already taking place in 2016. In July, GE sold its Italy-based financial services subsidiary GE Capital Interbanca to Banca IFIS, another Italian financial company as part of a process of reconfiguring to a "digital industrial" company.

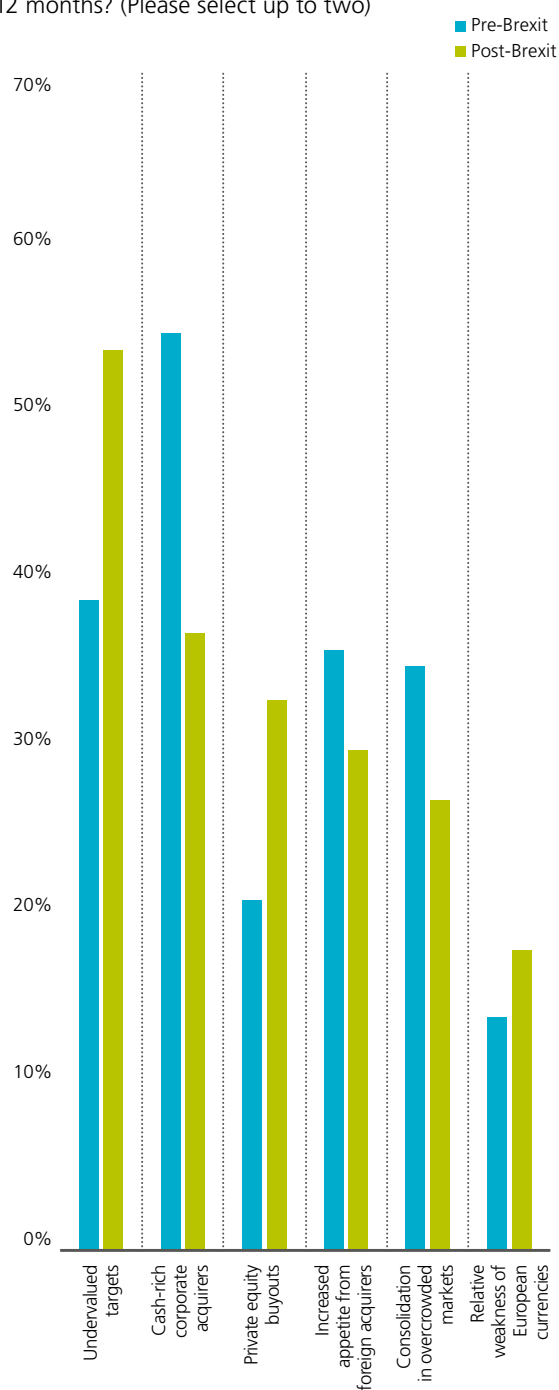
European utilities companies are also restructuring in the wake of lower electricity wholesale prices, and the long-term effects of government policy such as Germany's controversial energy transition. One company which has done this is Germany's RWE, which restructured its UK entity, Npower, in March. For more on restructuring and distressed deals, see *The money maze* p30.

There has been some evidence that the fall in the value of sterling has impacted pricing and we have seen increased interest from US acquirers in the UK market, in part looking to benefit from the currency arbitrage. Further, there is still very strong interest in UK M&A from Chinese and other Far East investors. However, this has been offset by caution from a number of European investors.

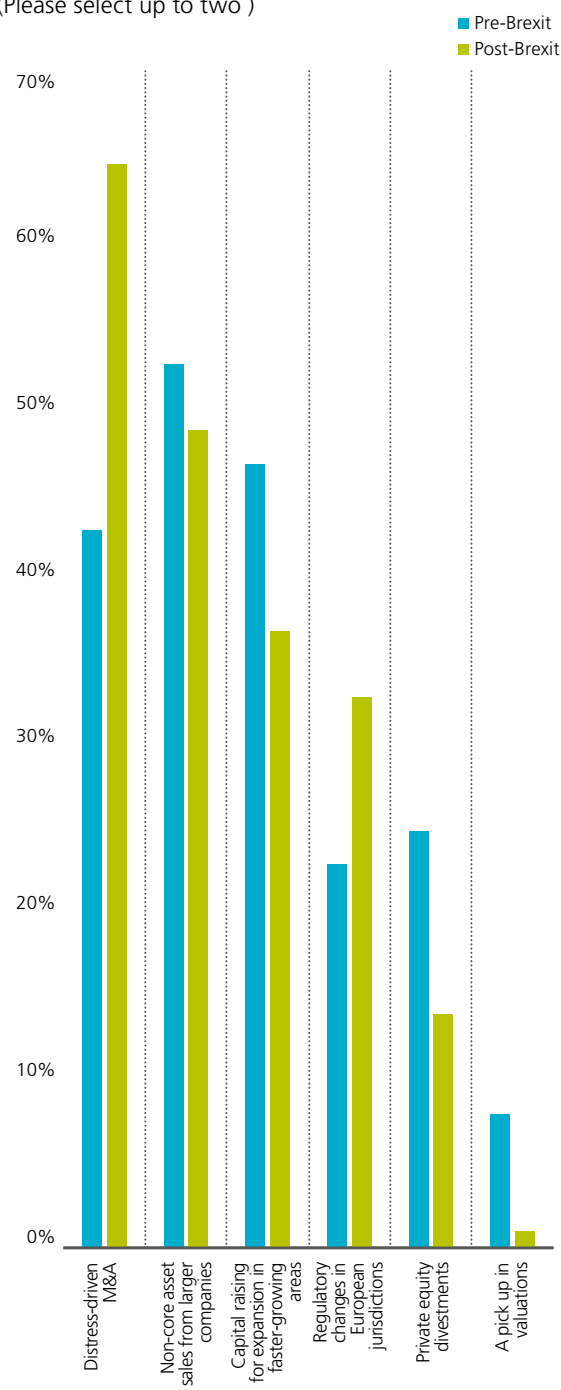
Charles Currier,
Head of
Corporate,
CMS London



What do you believe will be the greatest buy-side drivers of M&A activity in Europe over the next 12 months? (Please select up to two)



What do you believe will be the greatest sell-side drivers of M&A activity in Europe over the next 12 months? (Please select up to two)



Top 10 European M&A deals by value, 2016 Q1-Q3

Announced Date	Target Company	Target Sector	Target Country	Bidder Company	Bidder Country	Deal Value €(m)
03/02/2016	Syngenta AG	Industrial & Chemicals	Switzerland	China National Chemical Corporation	China	42,039
18/07/2016	ARM Holdings Plc (98.55% stake)	TMT	UK	SoftBank Group Corp.	Japan	27,276
21/07/2016	Credit Agricole - Regional Banks (25% stake)	Financial Services	France	Sacam Mutualisation	France	18,542
12/04/2016	Westdeutsche Genossenschafts-Zentralbank	Financial Services	Germany	DZ Bank AG	Germany	17,000
25/01/2016	Tyco International plc	Industrial & Chemicals	Ireland (Republic)	Johnson Controls, Inc.	USA	14,973
16/03/2016	London Stock Exchange (LSE) Plc	Financial Services	UK	Deutsche Boerse AG	Germany	13,339
27/06/2016	Meril S.A.S.	Pharma, Medical and Biotech	France	Boehringer Ingelheim GmbH	Germany	11,400
10/02/2016	Meda AB	Pharma, Medical and Biotech	Sweden	Mylan N.V.	UK	8,844
21/06/2016	Supercell Oy (84.3% stake)	TMT	Finland	Tencent Holdings Ltd	China	7,607
07/09/2016	Formula One Group	Leisure	UK	Liberty Media Corporation	USA	6,969

Another key sell-side driver could be regulatory changes in EU-wide or European jurisdictions. In our initial survey pre-Brexit, only 23% felt that this would be a key trend – however, post-Brexit this sentiment increases to nearly a third. Depending on the outcome of the UK-EU negotiations over the next few years, those companies that set up in the UK as a base to deal with the EU as a bloc may find their trade routes shut off.

As the partner in a UK-based PE firm puts it: “Some businesses have entered the EU and UK regions mainly so that they can benefit from the whole of the EU market. Now, due to differences in the jurisdictions they will end up

losing good growth opportunities as they will be unable to access other countries as planned. With that in mind, they could divest their assets, which could now be a good investment opportunity for local players to regain their market position.”

Deals from farther afield

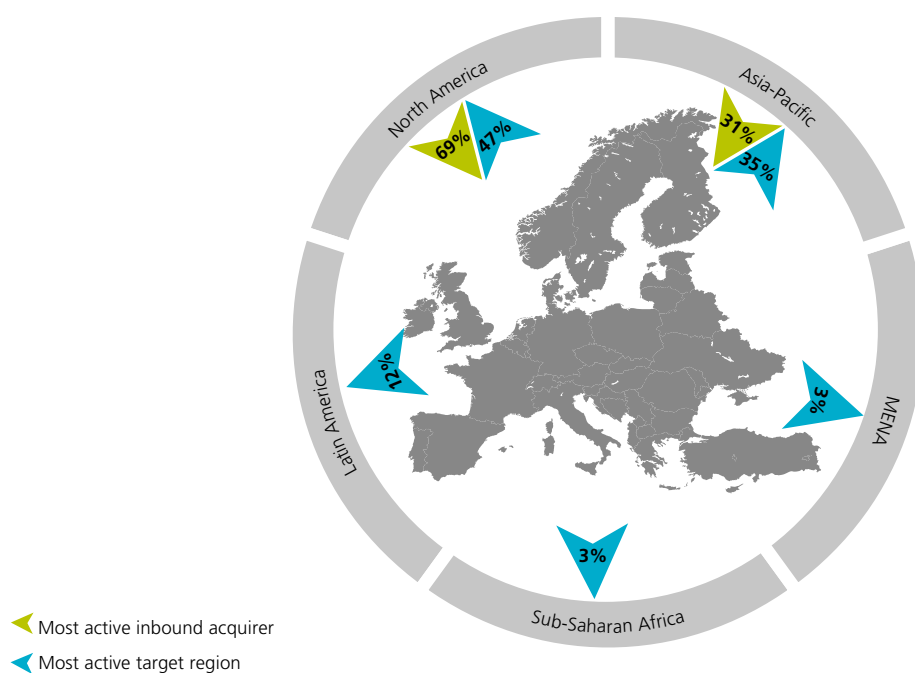
Despite the expectation that M&A activity overall will decline, the vast majority of respondents (79%) expect cross-border deals in Europe with non-European buyers to increase in volume, with 61% expecting an increase in value.

Europe’s large and competitively valued market will continue to attract investors from the US,

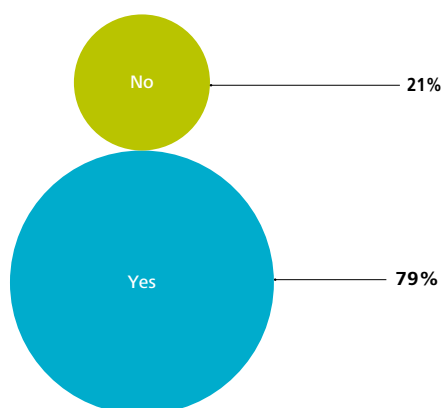
as well as Asian powerhouses such as China. More than two-thirds (67%) of respondents expect the US to be the leading inbound M&A acquirer, with 18% citing China, and 7% Japan.

So far this year five of the top ten announced deals are cross-border deals into Europe, including the two biggest. These are the acquisition of Switzerland’s Syngenta AG, an industrial company, by China National Chemical Corporation for €42.039bn and Japan’s SoftBank Group Corporation’s acquisition of 98.5% of UK-based ARM Holdings for €27.3bn.

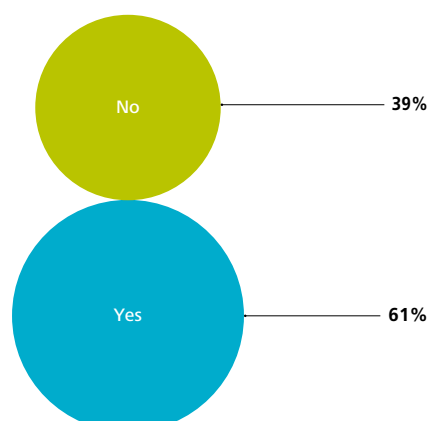
Which region do you expect to be the most active inbound acquirer into Europe and the most active target region for European acquirers over the next 12 months?



Do you expect the number of cross-border M&A investments into Europe (non-European acquirers) to increase over the next 12 months?



Do you expect the aggregate value of cross-border M&A into Europe (non-European acquirers) to increase over the next 12 months?



Sector watch

The age of industry

We look at the top sectors expected to emerge in European M&A over the coming year

In the first nine months of 2016, according to Mergermarket data, the top sectors by deal volume were industrial and chemicals, business services, and TMT, while the top sectors by value were industrial and chemicals, financial services, and TMT.

Respondents rate the industrial and chemicals sector as the most likely to see the highest M&A activity over the coming 12 months (44%), closely followed by TMT (43%). The other sectors expected to feature in the top five are consumer; energy, mining and utilities; and pharma, medical and biotech.

The single biggest M&A deal in Europe to date was in the industrial and chemicals sector, with the acquisition of Swiss agribusiness company Syngenta by China National Chemical Corporation for €42bn. Another major deal in the sector – and the fifth biggest overall – was Johnson Controls' acquisition of Ireland's Tyco International for €15bn. Tyco is a manufacturer of security,

fire detection and protection equipment, valves, pipes, fittings, and electrical and metal products.

The drop in the oil price has had a mixed effect on manufacturers. On the upside, it has reduced costs for many, including energy-hungry sectors such as metal manufacturing, and the petrochemicals sector. It should also boost the automotive industry by making car ownership less expensive.

On the other hand, industries that are geared to supplying the extractive industries and related downstream businesses have naturally suffered from a drop in demand. This has fed many of the mergers seen in the sector in the last two years, and Europe is no exception. ChemChina's takeover of Syngenta, for example, is predicated to some extent on saving costs and diversifying its agricultural portfolio.

“We still see high interest from foreign investors, particularly Asian and American, in German technology companies. Both strategic investors and private equity funds are looking for the same targets, making valuations high. ‘Digitalisation’ and ‘disruption’ are the key words in this market.

Maximilian Grub, Head of Corporate, CMS Stuttgart



Which sector(s) do you believe will witness the most M&A activity in Europe over the next 12 months?
(Please select up to two)



Chapter two

Deal dynamics

M&A is still an important growth strategy for corporates and PE alike – but uncertainty has caused a major pullback among businesses. For those still on the M&A trail, we explore the motivations for dealmaking and the key to an attractive target

Top findings

31%

were considering acquisitions prior to Brexit, this fell to 19% post-referendum

88%

of corporates and 89% of PE firms feel that favourable valuations are the main motivation for acquisitions

80%

believe technology/IP will be the most important aspect of their next European target

While economic and political uncertainty is clearly hampering appetite, many corporate and PE firms have substantial stocks of acquisition capital, and are looking to tap opportunities for acquisitions should the valuation, brand, and potential synergies align. Moody's reported in June that non-financial EMEA companies had around €921bn on their balance sheets at the end of 2015. Meanwhile, according to the same ratings agency, US firms held US\$1.7tn at the end of 2015, while PE firms had amassed US\$818bn in dry powder in June 2016, according to research firm Preqin. However, although large companies and their PE counterparts have the means, it would appear that, for the time being at least, they are lacking the motivation.

Brexit has had a significant impact on corporate demand for M&A. Prior to the referendum, just over

a third of corporate respondents (36%) said that they were not considering transactions. In the survey conducted after the Leave vote, this percentage increases to 54%, the highest proportion of respondents having no interest in dealmaking since the 2013 survey.

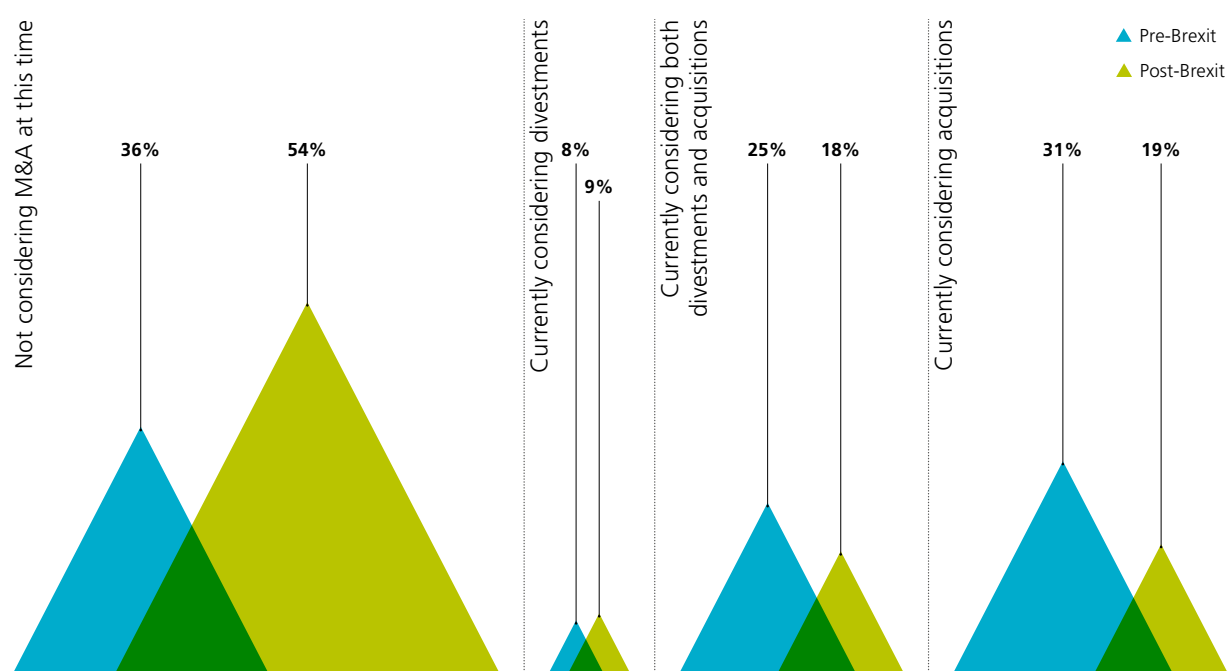
"The dealmaking environment has become very unfavourable because of the uncertainties surrounding Brexit and hence we are not planning to execute M&A in this challenging environment," says the head of development and strategy at an Ireland-based company.

Overall, in the post-referendum survey, 19% of respondents are considering acquisitions while a further 18% say they are considering both acquisitions and divestments. This could suggest that corporates are adopting a more flexible approach in response to global uncertainty.

Low prices and high tech

Post-referendum, we also find the motivations for deals have changed quite drastically. In our initial survey, the leading reason cited by corporates was growth in new geographies and customer bases (46%). In the second survey, however, almost nine in ten

Where does M&A currently fit into your corporate strategy?



corporates – 88% – see favourable valuations as the biggest buy-side driver. For PE firms, favourable valuations in Europe are the biggest draw (89%). However, growth in new geographies and customer bases is still a major factor, cited by 72% of corporates and 63% of PE firms.

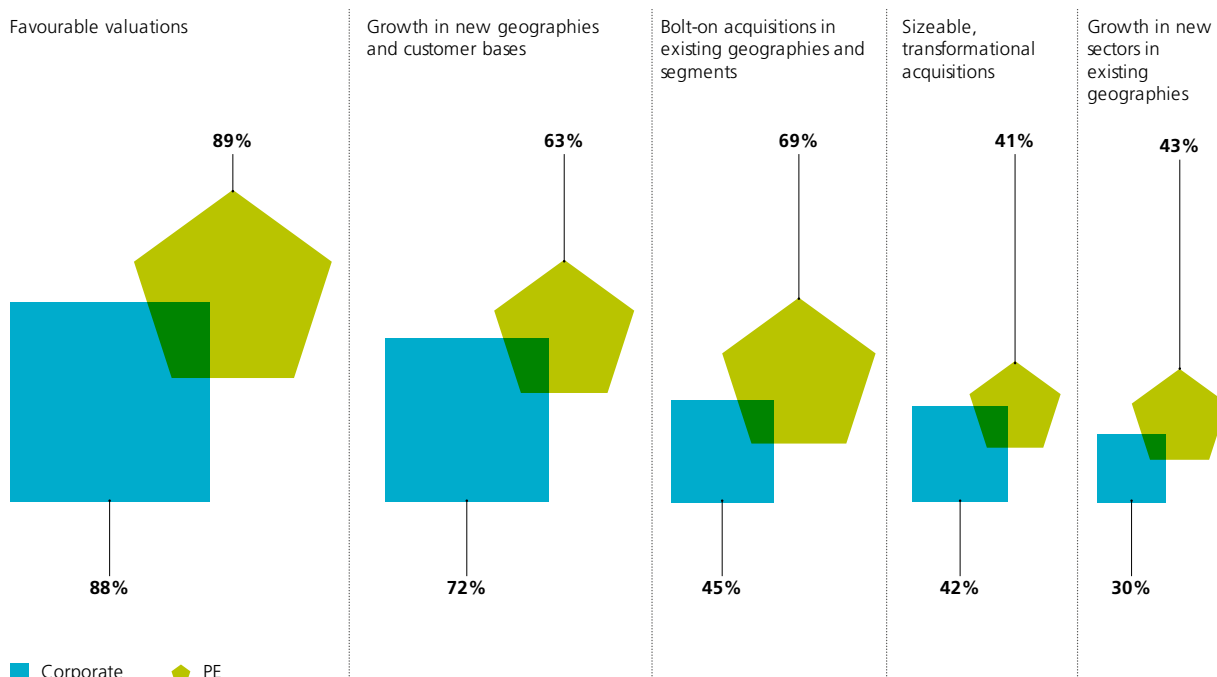
“Valuations have fallen due to uncertain economic conditions, and gaining access to businesses at a reasonable price makes the deal even more appealing,” says the director of strategy development for a UK-based corporate.

Technology is a game changer in many ways. Every ‘old economy’ company now needs to acquire and bolt on technology arms to fend off disruption of their primary business. On top of this, auxiliary functions such as payment, procurement, supply-chain management and even recruitment are being profoundly affected by technologically driven change.



Chris Watson,
Global Head of
Technology,
Media and
Communications,
CMS London

If you are considering acquisitions, what is the motivation for this? (Please select all that apply)



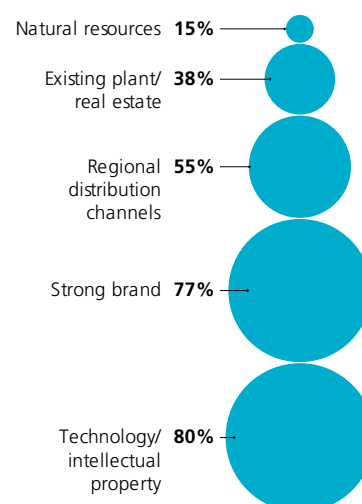
For those seeking targets, the most attractive aspects are technology and intellectual property, say 80% of respondents, followed by strong brands (77%).

Technology can allow companies to make a significant impact on a sluggish market and expand their customer base. For example, in early September, UK tech company Micro Focus bought Hewlett-Packard's software business for €7.83bn.

Numerous respondents picked up on the point about changing customer habits and the need for expansion through M&A to suit customer needs, including the CFO of a German corporate.

"Customers' demands are continuously evolving and the need for innovative products and new services has increased," he says. "We are therefore trying to fulfil customer demands and to do this we need to increase our product and service capacity which is easiest through an acquisition focused in the right direction."

What will be the most important aspect of your next European M&A target?



PE lessons

While the fractured economic and political climate may deter some investors, this volatility could possibly be the catalyst for PE firms that are hungry for bargains

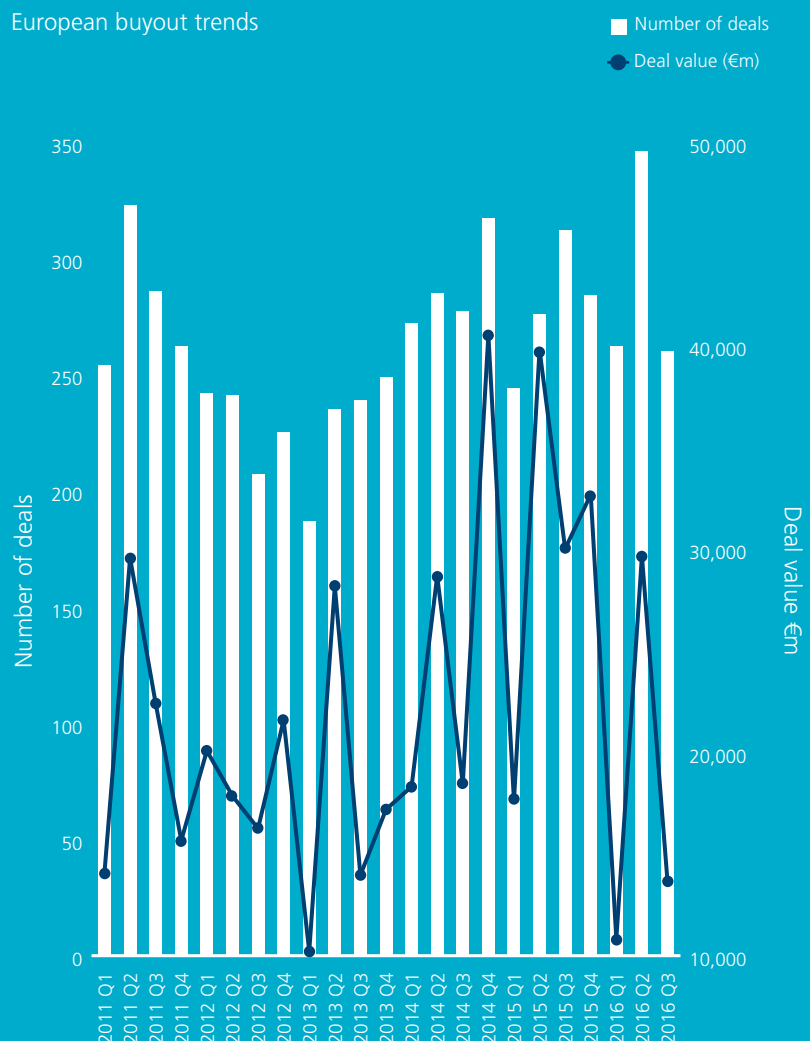
Global PE firms were sitting on close to US\$818bn in dry powder by June 2016, giving them plenty of scope to challenge their cash-rich corporate rivals for attractive targets.

In the first three quarters of 2016, PE buyout volume rose 4% on the same period in 2015 while value dropped 38%. On the other hand, exit volume fell 5% year-on-year over the same period, while exit value dropped 30%.

The deals may not be as big and routes out of investment may not be as clear. However, when it comes to spending, PE certainly sees opportunities.

"PE is in the ideal position to make investments as they are the best players to take advantage of events which shake the markets on a large scale," says the managing partner of a Belgian fund. "Valuations will be pushed down and it will be beneficial for PE companies. We ourselves will lock on to good opportunities."

European buyout trends



Activity is particularly lively in the Nordics, with 128 buyouts in Q1-Q3 2016, compared with 105 in the same period last year. Real estate, and in particular commercial real estate, in the Nordics has drawn the interest of both regional and US-based PE funds. For example, this summer US PE firm Blackstone, through its Swedish investment holding company Vega Holdco Sarl, bid for a 32% stake in Swedish property manager D. Carnegie & Co for €262m. And later in the year, US H.I.G. Capital, together with two Norwegian investors, acquired a 90% stake in Norwegian Raufoss Naeringspark for €137m.

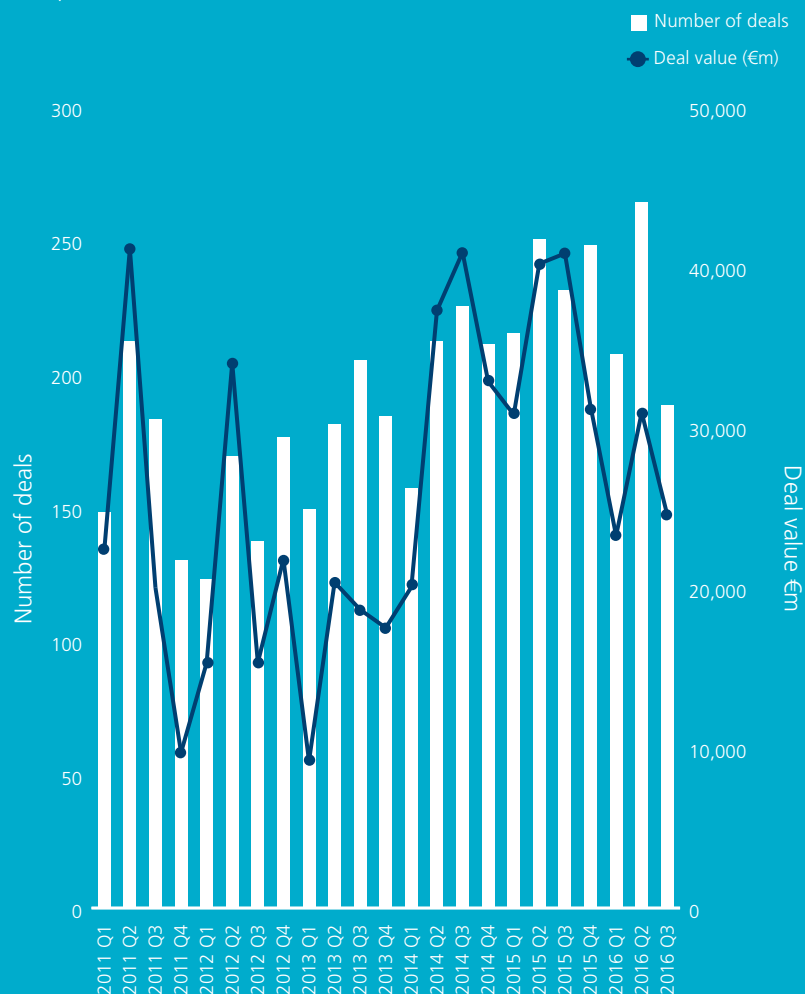
The Nordics are only behind the UK and Ireland's 177 and France's 164 deals, while Germany – a PE hotspot – lags behind with 96 deals.

On a sectoral basis, the industrial and chemicals sector led the way with 204 buyouts.

Respondents see opportunities spurring from low valuations and economic security in the Nordic region, recovering economies in Benelux, and France and Germany's relative stability following the Brexit referendum. Yet, conversely, there are many who see opportunities from Brexit.

"The UK will see quite a number of deals as foreign acquirers take advantage of falling sterling and look to enter the UK market before the terms have been discussed and finalised, which will create

European exit trends



complexity later; businesses might lose the chance of investing in this region soon," says a partner in a Spanish PE firm.

In the TMT sector, a major cross-border deal saw Netherlands-based NXP Semiconductors' standard products division acquired by a consortium of

Chinese funds JAC Capital Management and Wise Road Capital for €2.45bn. The deal shows both that Chinese appetite for European assets is not confined to the industrial and real estate sectors, and that Asian funds as well as corporates are showing interest across sectors in Europe. On top of this, it also

showcases PE's long love affair with the technology space.

Others were more conservative in their outlook and preferred bolt-on acquisitions in existing geographies rather than strategising around opportunities abroad. "We had planned to source a target abroad but later decided to make an acquisition within our existing geography as valuations declined. We were also comfortable working in our own jurisdiction to avoid cross-border regulatory pressures and loss of synergies," comments the managing director of a Dutch PE firm.

“ Even before Brexit, many PE firms were becoming concerned by the high valuation multiples, and that was already beginning to slow fund activity. A cooling of deal values, coupled with the vast amount of capital that has been allocated to the class, should spur some healthy PE dealmaking.



*James
Grimwood,
Head of PE,
CMS London*

“ PE often has significant advantages in terms of merger and regulatory clearances and access to funds. It has been a crucial founder investment type in so many startups and sunrise technologies; that will continue to be so and I think will in fact increasingly be so.



*Chris Watson,
Global Head of
Technology,
Media and
Communications,
CMS London*

Chapter three

Deal deterrents

Political turmoil and increased regulations are hampering the M&A market in Europe

Top findings

Political instability

in Europe is the principal obstacle to M&A activity

27%

of PE firms feel that Brexit will result in less appetite for investment into the UK

Volatility

in global capital markets will have the greatest negative effect on European businesses in the next 12 months

81%

believe that labour laws are the most challenging form of regulation when doing a deal in Europe

Over the past two years, Europe has been beset by several issues. From Greece's debt woes, via the ongoing migrant crisis and now Brexit, it is little wonder that political instability in Europe is ranked as the greatest threat to M&A activity, scoring 7.99 out of 10 as a risk factor.

Respondents echo these sentiments, and the prevailing concern for many is that there is little hope of a definitive solution in the short term. "This [instability] is not something that can be easily resolved and is a time-intensive process," says the finance director of an Italian corporate. "Hence we see this as a major obstacle for M&A activity in Europe. Due to political friction between countries in the EU, there is a lot of scepticism building up."

The three Rs – rules, rules, rules

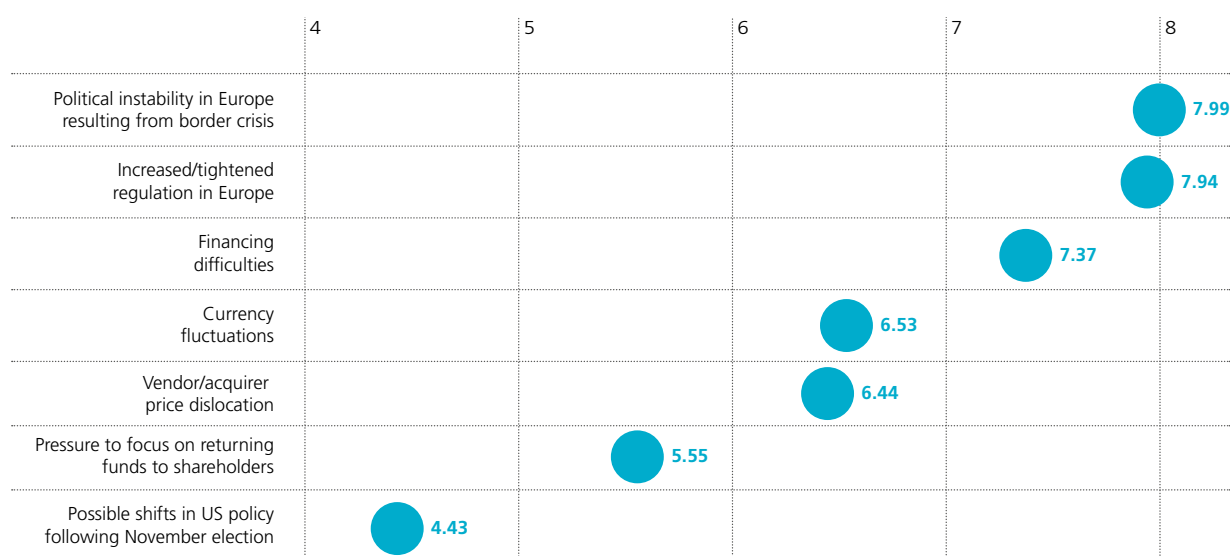
Increased or tightened regulation was ranked a close second as a downside risk to M&A, scoring 7.94 out of 10. And dealmakers have every right to be perturbed – €408.5bn worth of deals failed to complete in the first 8 months this year – the highest amount since

“Strategic M&A remains a good way to deploy capital in a low-growth market where funding is cheap and available. However, there is only so much political instability investors are willing to put up with, and Europe will need to clean its act up in order for investment to continue to flow.”

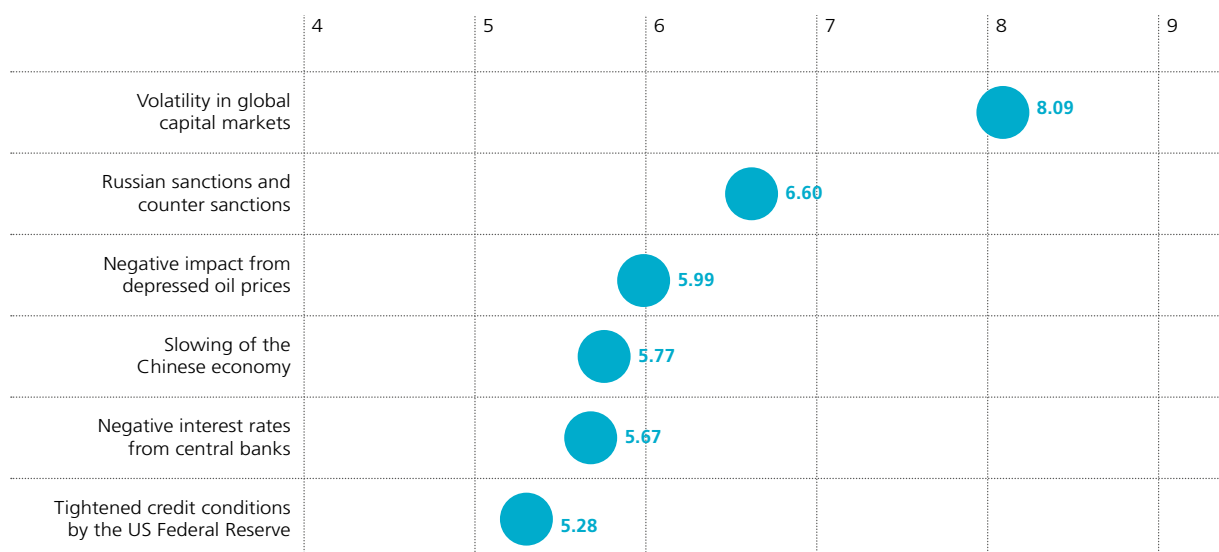
*Roman Tarlavski,
Corporate M&A
Partner, CMS
Amsterdam*



What do you believe will be the principal obstacles to M&A activity in Europe over the next 12 months?
(Scale of 1-10, where 10 = most significant)



Which external factors are most likely to impact negatively on the performance of European businesses over the next 12 months? (Scale of 1-10, where 10 = most significant)



2007, according to Mergermarket data. Many of these deals have collapsed due to regulatory pressure – including pharmaceutical giant Pfizer’s €172.6bn acquisition of Allergan and US oilfield services company Halliburton’s bid to merge with peer BakerHughes.

The UK referendum result can only amplify these problems, as the government may need to introduce a new regulatory infrastructure during and following its departure from the EU. Meanwhile, the EU itself could limit British-based companies’ access to the single market if the UK pursues a tough approach in the negotiation process.

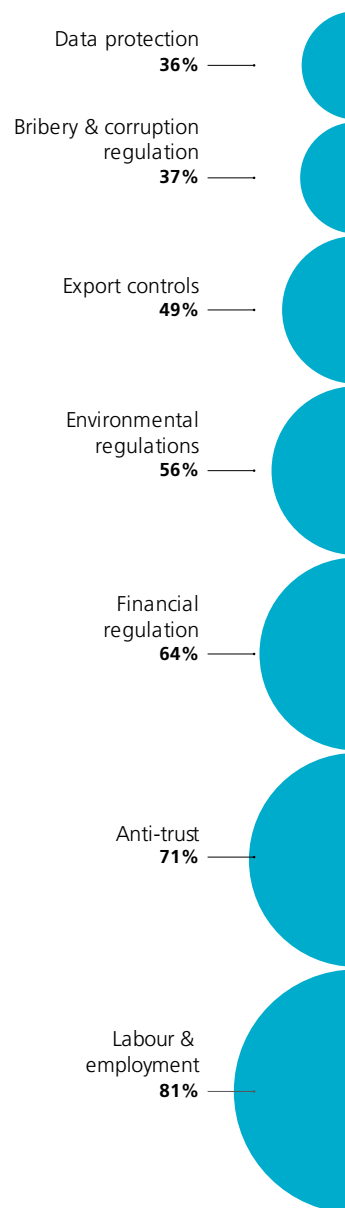
Many respondents bemoaned the complexity of the regulatory environment across Europe and feel that increasing regulation could strangle M&A. The idea of even more regulations over areas such as compliance, labour and capital requirements is only adding to dealmakers’ fears.

“New capital regulations are an ongoing process which will give administrative bodies additional control over business,” says the CFO of a Dutch corporate. “The introduction of a second tier of regulatory frameworks is in the pipeline and these may prove to be a gigantic barrier for businesses already operating or planning to venture into European markets.”

A number of respondents note that the complexity of labour laws in Europe can have a negative effect when trying to merge businesses. “[These laws] can have a huge impact on deal synergies,” says the CFO of a German corporate. “These rules increase the cost for businesses and are not very favourable for dealmaking.”

Anti-trust legislation (71%) and financial regulation (64%) round out the top three most challenging forms of regulation.

Which form of regulation do you find most challenging when doing a deal in Europe?



There is an ongoing trend towards more burdensome merger control proceedings. In addition, more and more authorities are also investigating competitive effects below the level of market dominance. This implies that a growing number of deals require a better understanding of potential antitrust roadblocks at an earlier stage of a deal to avoid costly surprises.



Michael Bauer,
EU Law and
Competition
Partner,
CMS Brussels

Reaping the rewards

While British investment may suffer as a result of the Leave vote, other European countries are ready and willing to accept investors looking for calmer waters

Our survey reveals that, in terms of M&A, the UK's loss could well be continental Europe's gain. In the wake of the vote, 35% of corporates say that they are likely to divert investment from the UK to Europe, while 42% of PE firms say the same. Indeed, 62% of PE firms that state that they have less appetite for M&A activity in the UK since Brexit say that they would look for deals in other European countries instead – while 44% of corporates say the same.

"We are planning on divesting our UK assets as we are predicting changes in the market that are going to affect our asset performances. Hence we are finding more suitable assets within the EU to cover our investments," says the partner at a German PE firm.

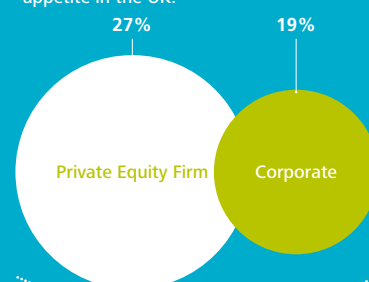
Germany is the most popular potential destination for investors seeking an alternative to the UK, say 60% of PE respondents and 71% of corporates, followed by France, according to 30% of

PE firms and 8% of corporates. The remaining 10% of PE funds would look first to Belgium, and the remaining 21% of corporates to the Netherlands.

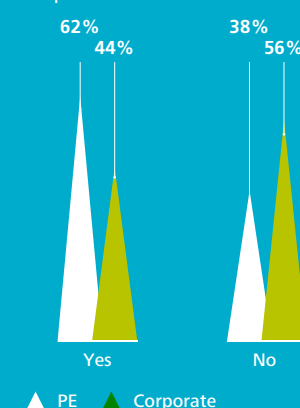
"The UK will definitely be under pressure as their dealing with other countries in the EU will be put on hold until the referendum outcome has been fully negotiated. This will impact business performances and the economy, making it less attractive for acquisition," says the partner of a French PE firm, who says he would be looking for deals in Germany.

Germany and France are both large markets with diversified economies and natural destinations for major deals. Germany has the potential to become a particularly interesting source of targets, partly through its Industrie 4.0 government strategy, that seeks to harness cloud computing and data to advance automation. For more on Germany's advantages, see *Regional round-up*, p28.

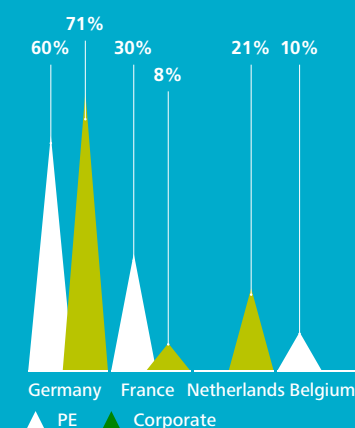
Respondents who said the main impact of Brexit on them would be less M&A appetite in the UK.



Would you then look for deals in other European destinations instead?



If yes, please specify which country.



Regional round-up

The UK still clearly leads the continent by a significant margin in terms of dealmaking. Despite Brexit, the pecking order in European M&A remains similar

According to Mergermarket data, the UK and Ireland top the table in terms of deal volume and value for Europe, despite Brexit.

But Germany is seen as the most-likely busiest M&A market next year with 44% expecting it to have the largest deal volume, and 70% seeing it as the probable leader in value. According to one Netherlands-based PE partner, Germany (alongside France) will see deals as “[their] countries’ economies are performing well compared with the rest.”

By contrast, confidence in the UK has declined rapidly. Our resurvey shows the UK now in seventh place for expected deal volume and fifth for value, compared with third place and second beforehand. However, the timing of the survey, straight after the Leave vote, could suggest an overreaction on the part of respondents, particularly considering volume has dipped just 10% so far this year.

Nordics

Volume	%	Value €bn	%
698	▼ 8	45.249	▲ 44

The Nordics are set to be Europe’s second-most active market in terms of volume. It has already made waves in H1, with Mylan buying Swedish pharmaceutical company Meda for €8.8bn. “The valuations there are extremely low,” says a partner in a Spanish PE firm. “The potential in business, combined with employee talent, will attract foreign market players.”

UK & Ireland

Volume	%	Value €bn	%
1077	▼ 10	123.401	▼ 45

While many respondents are down on the UK’s prospects, others feel Brexit’s impact could attract foreign buyers. “Because of the pound coming down I see a good opportunity for foreign acquirers looking for UK expansion,” says a French PE firm managing director. “Chinese and Indian companies will be leading the targeting.”

Germany

Volume	%	Value €bn	%
601	▼ 1	51.013	▲ 9

While Germany’s growth has been hampered somewhat, perhaps by increased risk perception and corporate pension liabilities, its macroeconomic and industrial strength make it an attractive prospect, particularly for Asian acquirers. This has been seen already with Midea Group buying 86.5% of automation firm KUKA for €3.8bn.

France

Volume	%	Value €bn	%
631	▼ 7	64.331	▲ 11

Benelux

Volume	%	Value €bn	%
416	▼-8	24.138	▼-42

Austria & Switzerland

Volume	%	Value €bn	%
204	▼-6	63.734	▲312

Russia & Ukraine

Volume	%	Value €bn	%
124	▼-9	8.243	▼-53

Iberia

Volume	%	Value €bn	%
305	▼-10	46.909	▲40

Italy

Volume	%	Value €bn	%
370	▼-12	37.195	▼-20

SEE

Volume	%	Value €bn	%
90	▼-31	4.557	▼-38

CEE

Volume	%	Value €bn	%
317	▼-5	7.062	▼-61

The CEE region is expected to see more activity in the coming months with distressed and non-core asset sales in the pipeline. AB InBev's acquisition of SAB Miller last year is continuing to generate divestments across Europe. Further divestments of the group's non-core operations in several Eastern European countries, valued at around €6bn, are expected to draw buyer interest over the coming months.

As well as those outlined above, there were 16 other deals worth €492m in other areas in Europe

Chapter four

The money maze

Private equity has been given its chance to shine as uncertainty in Europe casts a shadow over other financing sources

Top findings

94%

of respondents believe private equity will be the most available source of deal funding in the next 12 months

86%

see cash reserves as the most available funding source

86%

feel that financing conditions are harder in 2016 than they were in 2015

50%

state that distressed M&A will increase significantly in the next 12 months

The global monetary policy environment in 2016 is typified by historically low rates, with many major central banks taking an accommodative stance, and some continuing to pump stimulus into their respective economies.

However, domestic nuances are forcing central banks to move in different directions. The US Federal Reserve could potentially raise interest rates in 2016, following its first hike in several years in December 2015. Conversely, in August 2016, the Bank of England cut interest rates to 0.25% – the first reduction in seven years – and expanded its programme of quantitative easing (QE) in response to the EU referendum result, and with the aim of staving off a recession. Meanwhile, the European Central Bank's QE programme

continues following its March 2016 decision to cut rates and increase its bond-purchase programme.

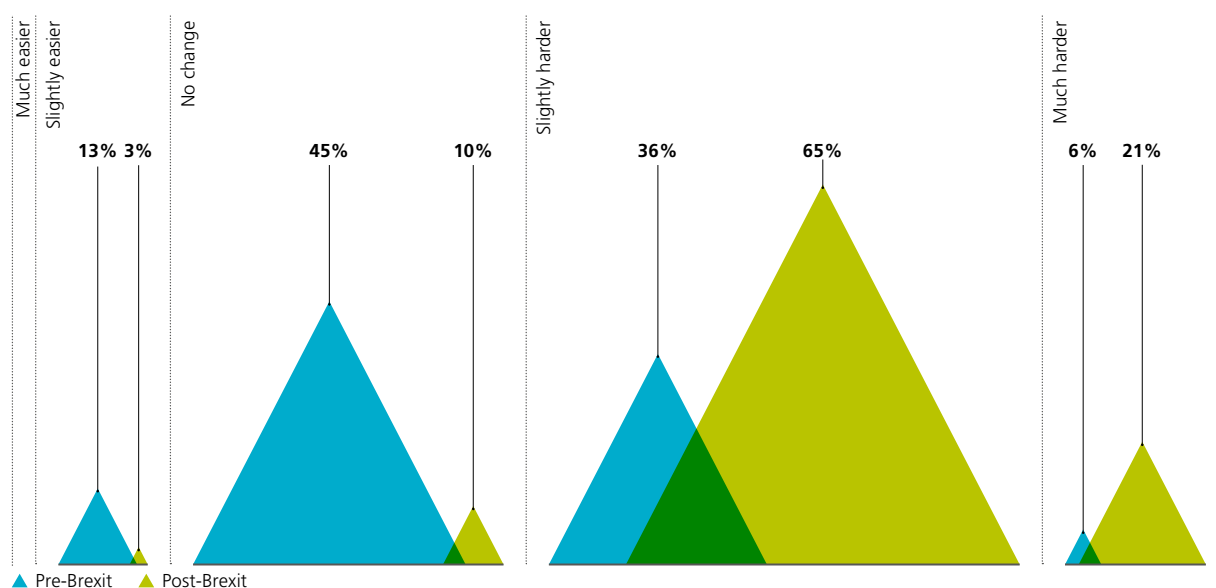
Rates and QE aren't the only factors; growing risk perception, increasing pressure from financial regulation such as Basel III and IV, and a shift towards ultra-safe assets such as US Treasuries are also impacting the availability of financing.

The vast majority (86%) in the post-referendum resurvey expect financing conditions to become more difficult, compared with 42% in the first survey. Now, 21% expect financing to become much harder, up from 6% before the referendum.

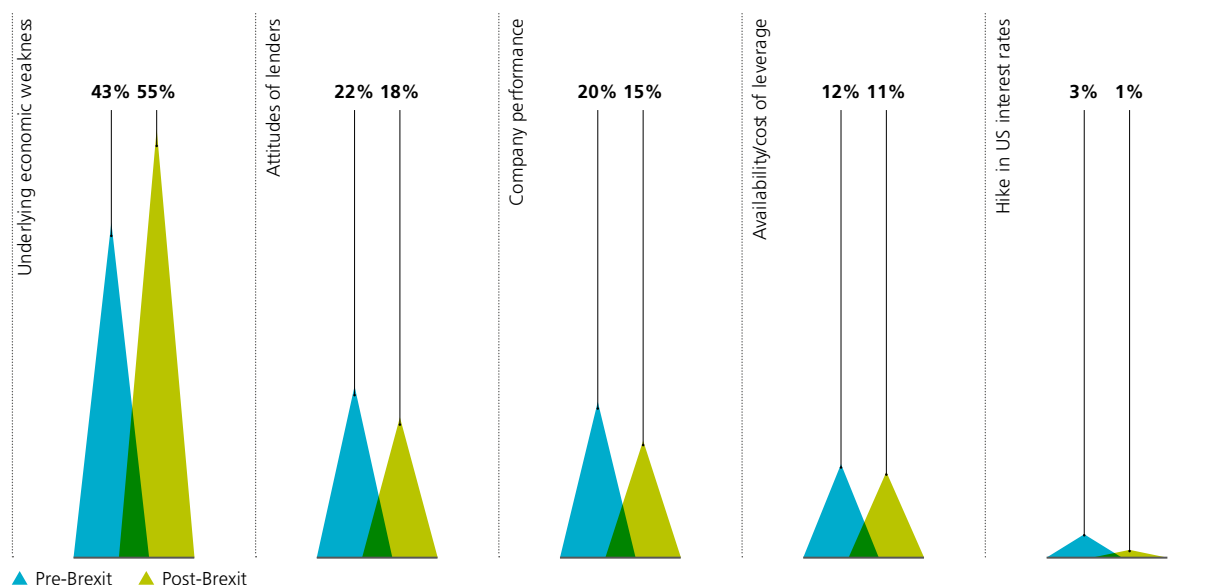
"Financing conditions will be slightly harder as banks are facing volatility due to several issues and changes in complying with the ECB's fiscal regime, and negative interest rates are affecting their financials which is why they have cut short on the lending activity. SMEs are the biggest losers in the bargain," says the partner at a German PE firm.

The most-favoured means of financing acquisitions is private equity, according to 94% of respondents, and cash reserves (86%). After the referendum, the proportion of respondents considering equity capital markets

How do you expect financing market conditions to be in 2016 compared to 2015?



What do you view as the greatest challenge to financing acquisitions over the next 12 months?



to finance acquisitions fell from a quarter of respondents to just 8%. Only 34% of respondents expect to turn to bank financing.

“Availing finance for new developments or M&A within Europe will be difficult as the financial markets are facing challenges with regards to the currency fluctuations and the loss of investor confidence in the region, which is reducing their ability to lend indirectly,” says the CFO of a Greek corporate.

A challenging environment

Underlying economic weakness is perceived as the single biggest challenge to financing acquisitions, cited by 55% of respondents, which is more than double the number of those who chose this option last year. The attitude of lenders is seen as the second biggest challenge to M&A financing (18%).

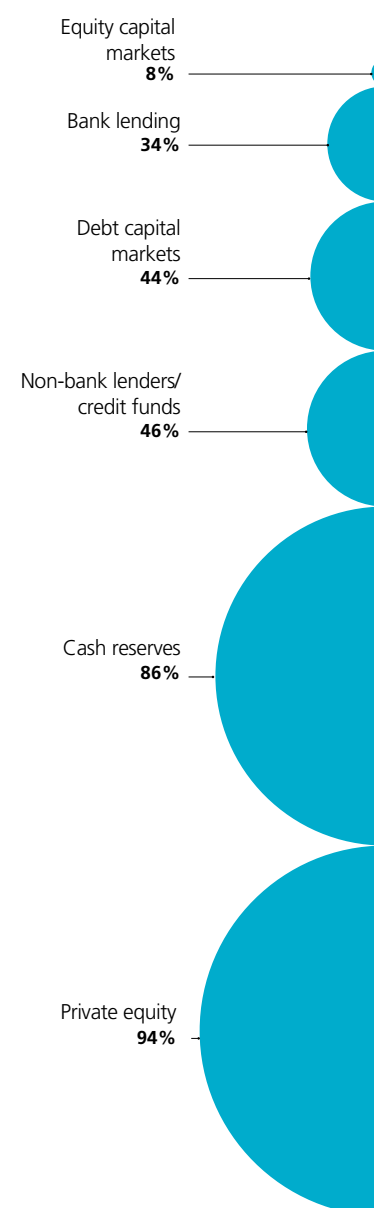
While there is very little that companies can do about underlying economic weakness, a number of respondents bemoan the disconnect between lenders and borrowers.

“Lenders’ attitudes have become rigid and inflexible as they are trying to avoid any kind of default or loss. The terms and covenants are now stricter and this is curbing the flexibility of the borrowers in the market,” says the director of strategy and business development at a Dutch corporate.

Rise of the restructurings

Respondents expect restructurings (91%) and distressed M&A (93%) to increase over the coming year, probably due to rising market uncertainties and the impact of lower commodity prices on companies in sectors including mining and energy. Expectations for a rise in these sorts of activities have also risen

Which sources of financing do you think will be most available over the next 12 months?

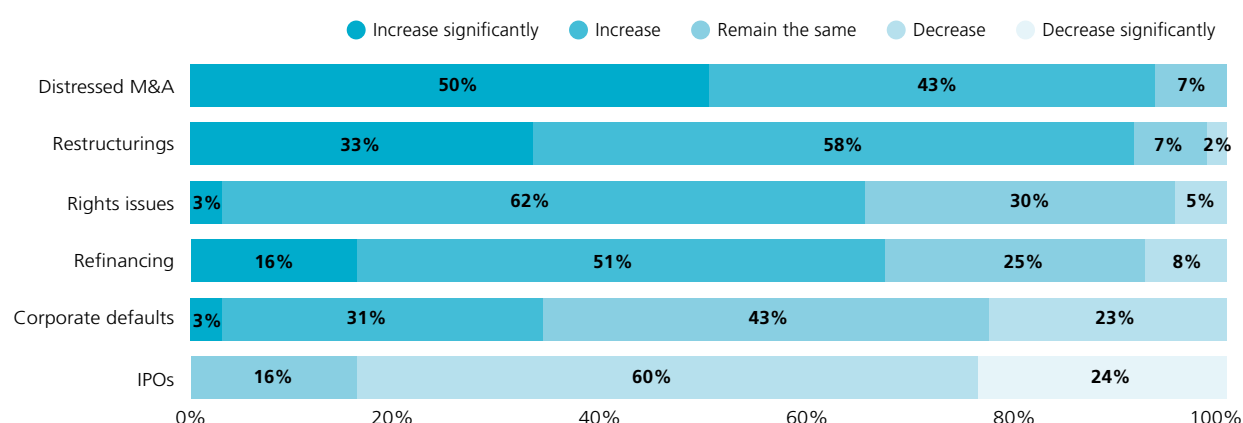


Lender-borrower relationships are mainly based on corporate trust. Corporate trust is the pillar of stronger and long-term lender-borrower relationships, and requires a track record of meeting obligations arising from previous financings. Transparency is also key, and may strengthen ties even under adverse circumstances if the borrower is able to anticipate difficulties and openly discuss the situation with the lender.



*Abraham Najera,
Banking Partner,
CMS Madrid*

For each of the following transaction types, please rate your expectations for activity over the next 12 months



since the Brexit vote, with those anticipating more restructurings and distressed M&A rising from 86% and 74%, respectively.

“Businesses are unable to fulfil the increasing regulatory requirements which will expose them to external threats,” says the head of finance at an Irish corporate. “Therefore the lack of capacity to transform the business to achieve growth will end up in distressed business conditions.”

The Italian banking sector has also come under pressure from a high level of non-performing loans (NPLs) and a lack of profitability. These factors were behind the €3.7bn merger of Banca Popolare di Milano and Banco Popolare agreed in March. The Italian government is encouraging consolidation in the sector, which has been struggling to recover from Italy’s three-year

recession, in which a €360bn-debt mountain of NPLs has built up.

Should commodity prices remain low, there may be more deals like Glencore’s sales in April and June of 2016 of 40% and 9.99% stakes in its agriculture division to the Canada Pension Plan Investment Board for a combined €2.75bn. Glencore, a mining and commodity company, is targeting more than €4bn of asset sales this year as it looks to reduce its debt pile amid weak commodity prices.

The expectation of new flotations on stock exchanges has fallen dramatically since the referendum, with those expecting a decrease in IPOs rising from 29% to 84% in the resurvey.

Increased regulator pressure and/or higher provisioning levels, a renewed focus by financial institutions on their core businesses and available private equity capital have stimulated distressed debt deals. This is ranging from pure NPL portfolio deals to transactions also encompassing servicing platforms and entire non-core business units.

Alexander Rakosi,
Corporate Partner,
CMS Vienna



Conclusion

European M&A faces a time of uncertainty yet opportunity as we enter the tail-end of 2016. We outline the key factors to consider for your dealmaking strategy going forward

The Brexit referendum casts a long cloud over the European M&A landscape, with an increase in uncertainty and rising concerns that the vote will lead to an economic slowdown. This will clearly affect the UK, with little sign of which trade and regulatory arrangements might emerge as Brexit is finalised.

In spite of this, it is notable that levels of M&A have not dropped off significantly since the vote and Europe is making it clear that it is still open for business – with buyers from the US and China expected to be particularly active.

The key for European dealmakers is to ensure that Brexit does not become a self-fulfilling prophecy and that they follow four key steps to keep the M&A market rolling:

Look to the core. The sluggish global macroeconomic environment has led to companies re-focusing on their core business and paring off under-performing divisions. This seems unlikely to change, and firms should look to follow suit.

Look further afield. Buyers are refocusing their activities away from the UK. Countries that are expected to benefit include major markets Germany and France, as well as the Nordic markets, which are seen as having favourable valuations. Exploring which market is best for you post-Brexit is key.

Private equity's higher profile. While the financing environment is expected to become considerably tighter as uncertainty rises, many players are still cash-rich and able to do deals when the targets

are right. PE has capital ready to deploy, and with the trouble in Europe this year, some see growing opportunities from lower valuations.

Bear or bull? The British referendum has cooled appetite for M&A among many players in what was already an uncertain environment. However, opportunities certainly still exist in the market. For some, the risk will be worthwhile. Others will wish to see how Brexit negotiations unfold, focusing on other European markets that offer advantages in size, location, and valuation. Assess which path is right for you.



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Contact us:

CMS Austria

Peter Huber

T +43 1 40443 1650

E peter.huber@cms-rrh.com

CMS Belgium

Vincent Dirckx

T +32 2 74369 85

E vincent.dirckx@cms-db.com

CMS CEE

CMS Czech Republic

Helen Rodwell

T +420 2 96798 818

E helen.rodwell@cms-cmck.com

CMS Serbia

Radivoje Petrikić

T +38 1 3208 900

E radivoje.petrikic@cms-rrh.com

CMS France

Jacques Isnard

T +33 1 4738 5500

E jacques.isnard@cms-bfl.com

CMS Germany

Thomas Meyding

T +49 711 9764 388

E thomas.meyding@cms-hs.com

John Hammond

T +49 711 9764 382

E john.hammond@cms-hs.com

CMS Italy

Pietro Cavasola

T +39 06 4781 51

E pietro.cavasola@cms-aacs.com

CMS The Netherlands

Roman Tarlavski

T +31 20 3016 312

E roman.tarlavski@cms-dsb.com

CMS Portugal

Francisco Xavier de Almeida

T +351 21 09581 00

E francisco.almeida@cms-rpa.com

CMS Russia

Natalia Kozyrenko

T +7 495 786 4000

E natalia.kozyrenko@cmslegal.ru

CMS Spain

Carlos Peña Boada

T +34 91 4519 290

E carlos.pena@cms-asl.com

CMS Switzerland

Stefan Brunnschweiler

T +41 44 285 11 11

E stefan.brunnschweiler@cms-vep.com

CMS United Kingdom

Martin Mendelssohn

T +44 20 7367 2872

E martin.mendelssohn@cms-cmck.com

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Karina Ross

Head of Sales EMEA, Remark
The Mergermarket Group

T +44 20 3741 1058

E karina.ross@mergermarket.com

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**10 Queen Street Place
London
EC4R 1BE
United Kingdom**

T +44 20 3741 1000
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FL 4
New York, NY 10013
USA**

T +1 212 686 5606
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sales.us@mergermarket.com

**Suite 1602-06
Grand Millennium Plaza
181 Queen's Road, Central
Hong Kong**

T +852 2158 9700
F +852 2158 9701
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