

C L I F F O R D
C H A N C E

A GLOBAL SHIFT

THE AGE OF INFLUENCE

Our M&A insights and
deal intelligence 2018

CLIFFORD CHANCE

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THE AGE OF INFLUENCE

“Welcome to our annual review of global M&A. As boardrooms and investors look forward to a strengthening economic outlook in 2018, we explore some of the forces and trends that will shape the M&A environment.

Long-established businesses are fired up by the need to transform as they seek to take on the challenge of tech titans, new entrants and start-ups. Data residing within their own systems, as yet not fully monetised, is their greatest asset as they fight to stay relevant in fast-changing markets.

We are in an age of influence, where shareholder activists are training their sights well beyond their traditional North American hunting ground. Listed companies need to become more active in managing shareholder expectations and responding to unexpected demands.

Recent political upheaval in the US and across Europe has led to shifting views on the benefits of globalisation and some governments are tightening channels for foreign direct investment in response, in part motivated by populist demands. Others, including China, are beginning to open up as they weigh the benefits of inbound investment.

The private equity industry’s funding and fee model is under pressure with ever-growing levels of undeployed capital and fierce competition for quality assets.

These are just a few of the evolutionary shifts and market changes which we expect to drive M&A activity in the coming year. I hope you enjoy the report and, as ever, welcome your feedback around these developments.”




Guy Norman,
Global Head of Corporate,
Clifford Chance LLP



An abstract background featuring a vibrant explosion of green and blue particles against a black backdrop. The particles are concentrated in the center, creating a bright, glowing effect that fades into the dark background towards the edges. The colors transition from a bright yellow-green in the center to a deep teal and blue towards the bottom and sides.

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DATA ALCHEMY



A new asset class comes of age

Investors are prepared to pay more for a target with data assets which sharpen their competitive edge, helping them to create new products and unlock new revenue streams.

The vast majority of global data lies with 'non-tech' companies and much of this has yet to be converted into tangible value. 2018 will see established companies making more of their data, spurring continued growth of mid-market tech M&A activity.

Incoming data privacy regulation is defining what businesses can and cannot do with their data - from the EU's General Data Protection Regulation (GDPR) to the People's Republic of China's recent cyber-security law. This is becoming a key driver of strategy and deal structure.

US\$ 15.3bn

Intel-Mobileye deal - One of the largest deals driven by Artificial Intelligence (AI)/Internet of Things (IoT) to date

2.5 quintillion

The bytes of data produced per day

€739bn

Predicted value of European data economy by 2020

THE DATA-DRIVEN TRENDS WE ARE SEEING

MAXIMISING STRATEGIC OPPORTUNITIES BY MANAGING CYBER AND REGULATORY RISK

The emergence of data as a coveted asset class is changing how buyers approach deals.

- **The value of data:** High profile, data rich targets have been acquired at significant discounts, signalling a shift from traditional valuation methodologies. As acquirers become more familiar with the associated risks, they are adapting their approaches to valuation. Innovative solutions are being devised to bridge valuation gaps – from straightforward milestone-related payments to more sophisticated revenue-sharing arrangements.
- **The dark side of data:** We have recently seen some of the largest data breaches in history hitting valuations. Cyber risk sits among the top items on diligence agendas, particularly where data is core to the target's business, yet it remains a difficult area to diligence as big-impact issues may remain latent, deep in the target's systems.
- **Regulatory drivers:** Data-driven deals have not been confined to the traditional centres of the data industry. Investors are following tech talent and making acquisitions where they find it. For buyers, this means getting familiar with new and different regulatory environments and market practices. Increased regulatory scrutiny in Europe and the US has not resulted in a flight towards 'regulatory-light' jurisdictions as many established jurisdictions are also hubs of tech talent and will continue to attract investment.
- **Defining ownership:** Data cannot always be owned under traditional forms of intellectual property ownership. So in order to realise the value of target data, deal documents must secure rights equivalent to ownership. Understanding the target's rights over data is critical - overlooking this creates future execution risk. As the law evolves, so will the strategies to achieve the right control and ownership over acquired data.

“Diverging standards can close off rather than create opportunities. Achievements of some of the Chinese tech giants at the cutting edge of AI and big data, for example, may not export well into markets where stricter personal data regulation could undermine their data collection and processing models.”



Luke Grubb,
Head of Asia
Technology group,
Singapore

DEAL INSIGHTS

DATA IS AT A PREMIUM. BUSINESSES ARE PREPARED TO PAY LARGE SUMS FOR ASSETS THAT ENABLE BUSINESSES TO TRANSFORM.



DARK DATA – BIG DISCOUNTS

Valuation and proper diligence come together – buyer beware

- In February, Verizon and Yahoo announced that Verizon would pay US\$ 350m less for Yahoo's internet businesses after the discovery of historic data breaches (valuing the deal at about US\$ 4.48bn in cash) - months after the companies had reached their initial agreement.
- This discount shows the importance of understanding the risks associated with data targets, integrating robust contractual protections into deal documents, considering insurable risks and building in flexibility to re-negotiate price should issues come to light after the deal is signed.



TREASURE TROVES

Moody's buys Dutch data provider Bureau van Dijk

- US credit agency, Moody's Corp, acquired Bureau van Dijk for €3 bn. This data-rich target has been described as holding one of the world's largest business databases, with information on more than 220 million private companies.
- Moody's said that the deal provides significant opportunities for its existing analytics tools to offer complementary products, create new risk solutions and extend its market reach.



INCUMBENTS PIVOT TO THE NEW

Cisco's US\$ 125m acquisition of MindMeld Inc.

- MindMeld Inc. developed a platform to enable customers to build an artificially intelligent conversational interface.
- The deal was one of many examples of more traditional tech companies joining in the AI race to stay relevant.



THE 'I'-FACTOR

Data business Mobileye was acquired by Intel

- In August, Intel and Mobileye closed one of the largest Israeli tech deals by value ever – an example of Israel's investment in its data superstars beginning to bear fruit. The consideration was US\$ 15.3bn.

“The key to realising the full potential of data lies in planning to win. The winners are those who can refine and unbundle the ‘useful’ data from the ‘crude’ and create structures to assert ownership rights over useful data.”

Jonathan Kewley,
Technology Partner,
London

TALENT: THE RISE OF THE DATA SUPERSTAR

THE CLIFFORD CHANCE PERSPECTIVE

Talk of data and technology assets can obscure one critical factor to deal success: the individual talent behind the technology.

- The success of a data-driven deal depends on the buyer's ability to extract and re-use the target data, but this is often challenging without the people who created and understand the data set and supporting systems. It's important and often essential for a buyer to secure the knowledge and experience of those individuals.
- Incentivisation and maximising management and talent buy-in become ever more important. This evolution will soften the severity of traditional, buyer-friendly, staggered payment structures.
- The 'data superstar' is often an individual or group of founder managers, who are significantly invested in the target on both a personal and financial level. Deal documents give weight to such individuals' concerns, particularly from a tax and personal liability point of view.
- Buyers may be inclined to focus more on incentives and less on harsher contractual protections, where the seller is an individual they need to retain. There will be less focus on bare financial performance and more on reward and retention.
- Earn-outs tied to realising specific business objectives are increasingly prominent. The focus on incentives drives deal terms as complex bonus structures can be decoupled from the main transaction documents and agreed in separate employment and option documentation. This adds complexity to negotiations.
- When a business reaches a certain level of maturity, the role of data superstars may need to be reassessed. SoftBank's data megadeal at the end of 2017 – a consortium investment in Uber – included the negotiation of two new 'buyer' seats on Uber's board, with the intention of reducing the influence of some of Uber's early leadership and enhancing standards of governance.

2018 – LOOKING AHEAD

“Data superstars will continue to influence the dynamics of data-driven deals. However their role in governance structures post-acquisition is likely to diminish as these businesses achieve scale.”

Anand Saha,
Corporate Partner,
New York



5 PRACTICAL TIPS TO GET THE DEAL DONE

Acquisitions of data-rich companies require careful planning to ensure the opportunities can be realised and data related risks mitigated.

Address risks

Cyber security risks and antitrust compliance play out differently, even for similar data businesses. Historic data liabilities may lie in wait for even the most careful of acquirers. Pricing structures and valuations do not always contemplate the acquirer's responsibility to 'make good' any breaches discovered post-completion.

Focus on diligence

Working with management teams on diligence has never been more important. Take time to understand the target's rights over its data and where it is located, map data flows and identify key processing steps. Make sure the business understands its obligations, has robust data procedures and secures the right permissions from its customers. Beware if the target appears to have taken a 'grow first, comply later' approach.

Secure ownership

Securing the value of target data means securing the rights to do what you want with the data. Plan for this and identify what rights you need. Verify ownership in these rights and tailor deal documentation accordingly. Monitor future laws regarding data ownership. Address compliance deficiencies through a pre- or post-completion plan and purchase price adjustments.

Integrate data

Planning for how data will be integrated post-completion should start long before the deal is inked. Post-completion integration of new systems and data is a technical issue, but it also has multiple legal aspects. Ensure your legal and technical teams work together to plan the transition.

Incentivise talent

Use bonuses and consideration structures to retain the creativity and dedication of business founders and key employees. Fine-tune incentives by working closely with management to understand key motivators and future objectives.

2

UNDER PRESSURE





Shareholder activism in M&A 2018

Shareholders of listed companies are increasingly influencing boardroom decision-making globally. Activism is growing beyond traditional North American markets into Europe and Asia.

A common campaign focus is M&A, where activists seek better returns through pressuring boards to sell underperforming businesses or influencing pricing on takeovers.

The strategies that activists can employ are varied, as are the types of investors seeking to bring about change. Listed companies need to respond in a new era of shareholder engagement, and take into account the style, tactics and demands of the relevant activists.

805

Number of activist campaigns started in 2017 globally*

+99%

Increase in activist campaigns against European HQ companies over the last 3 years*

44%

Percentage of activist campaigns launched in 2017 that were partially or wholly successful*

30%

Percentage of campaigns focused on M&A, corporate strategy or balance sheet activism*

THE ACTIVISM TRENDS WE ARE SEEING

A NEW ERA OF ACTIVISM

We are in a more dynamic era of shareholder activism with players and tactics more varied and activists working across a broader geographic area.

- **No longer simply the aggressor:** The perception of activists as 'corporate raiders' - using aggressive media campaigns, litigation and proxy fights to effect change for short term investment and gain - has evolved. Today, shareholder activism is multi-faceted and demands a more tailored response from the target.
- **US activists broaden their horizons:** Activist campaigns peaked in 2016 and 2017. In North America the rise was moderate, but activity has surged in Europe and Asia. US activists looking outside their saturated domestic market are finding friendly legal and regulatory climates to pursue targets abroad. Activists in Europe and Asia are meanwhile initiating more domestic campaigns.
- **Activism transcends industries and market caps:** Mid caps in certain sectors have been traditional targets for activism, but no corporation is immune in today's relatively low return economic climate. Investors actively seeking higher returns can turn their spotlight on the strategy, business and management of any enterprise perceived not to be optimising returns. Size is no barrier.
- **The many faces of activism:** Activists are increasingly sophisticated, employing an array of tactics in an attempt to achieve their aims. The philosophy and approach can vary significantly. They can be hostile or collaborative, public or private, active or passive. At the same time, more traditionally passive shareholders – including institutions, index funds and private equity funds – are deploying activist tactics as the line between 'corporate raider' activist and institutional shareholder is blurred. For example, hedge fund investors may be seeking more long-term investment growth through their demands, while some institutional shareholders and index funds are supporting activist agendas and increasingly voicing their own opinions.
- **M&A is a focus:** M&A is often a focus for activists as a means of enhancing returns. Activists may oppose existing M&A transactions (e.g. Clariant/Huntsman) or undertake bumpitrate campaigns (e.g. KKR/Hitachi Kokusai). In other cases they agitate companies to undertake M&A and shake up existing businesses (e.g. Whole Foods).

“We are seeing increasing levels of activism in Japan as recent reforms in the corporate governance and stewardship codes encourage greater dialogue between companies and their shareholders. Activists are pursuing strategies linked not only to financial returns but improved corporate governance, in line with developments in the US and Europe.”



Natsuko Sugihara,
Corporate Partner, Tokyo

DEAL INSIGHTS

ACTIVIST SHAREHOLDERS HAVE BEEN SUCCESSFUL IN EUROPEAN M&A CAMPAIGNS IN RECENT MONTHS

Active stake-building

Clariant AG (Switzerland, Chemicals)

- In May 2017, Clariant announced a merger of equals with US-based Huntsman valued at approximately US\$ 20bn. In July, activist investors Corvex and 40 North (acting through White Tale Holdings) publicly opposed the transaction, stating that it lacked strategic rationale, would destroy shareholder value, and undervalued Clariant.
- When White Tale began its campaign it disclosed a 7.2% shareholding in Clariant but subsequently increased its stake to 20%. In October 2017, Clariant and Huntsman jointly abandoned the merger citing uncertainty over shareholder approval.

Public agitation

AkzoNobel N.V. (Netherlands, Industrials)

- Activist investor Elliott launched a public campaign against Dutch paint and industrials company Akzo for failing to negotiate a takeover with its US rival PPG Industries in response to its unsolicited bid of approximately €27bn.
- After law suits and bold public relations campaigns, Akzo agreed to three new board nominations supported by Elliott and sold its specialties chemicals business, although the PPG bid did not proceed.

Strategic long-termism

Safran SA (France, Aerospace)

- In January 2017, Safran agreed to buy Zodiac Aerospace SA, a French listed aerospace company. Activist shareholder TCI Fund Management (which had been a Safran shareholder for five years), claimed the merger was significantly overpriced. TCI also questioned synergies, deal structure and its fairness to shareholders.
- Safran adjusted the share ratio and reduced the headline price which, according to TCI, resulted in an aggregate price reduction of approximately 26% (from €9.5bn to €7bn). Safran also restructured the deal and accepted TCI's share buyback suggestion.

KNOW YOUR ACTIVIST

Most activist demands are premised on seeking increased shareholder return, but a broad range of tactics can be employed. Within any given campaign, several of these might be used in tandem:



Payout Seeker

Seeking cash returns through special dividends, share buybacks, recapitalisations. Proposing a sale or other M&A-based strategy to reward shareholders.



Portfolio Appraiser

Evaluating the business divisions and structure of a business. Recommending divestments and spin-offs. Opposing planned mergers.



Boardroom Agitator

Injecting new blood to stimulate action in the boardroom. Calling for CEO replacement or executive compensation changes linked to performance.



Strategist or Reformer

Looking for a long term strategic shift or shake-up in current goals. Might look for a board seat to influence strategic direction.



Bid Opportunist

Buying in to get short term gain in a takeover situation. Undertaking 'bumpitrague' to increase the bid price.



Ethical Activist

Pushing for change around a wide range of sustainability and ethical issues, such as climate change or gender and diversity gaps. The Ethical Activist is the new kid on the block.

PROACTIVELY MANAGING ACTIVISM

THE CLIFFORD CHANCE PERSPECTIVE

Managing shareholder activism means reacting in a transparent and considered way, but prevention is better than cure.

- However it manifests itself, public companies should not lose sight of the basic objective underpinning most activist approaches: improving return on investment. Underlying those campaigns will be the claim that the company is underperforming and not properly maximising returns for shareholders. However, each activist has its own investment philosophy and toolkit of tactics which will be tailored to a particular scenario.
- Companies should expect that the activist has invested a significant amount of time and effort in analysing the company and the situation, so a knee-jerk defensive approach or automatic rejection is rarely a good idea.
- The appropriate response requires preparation and coordination, with the right advisers, principals and board members involved. Companies should listen to the activist's demands, weighing the short versus long term impact. Activists may not always be right, but they typically know the company well and may be a source of value creation.
- A company's best defence to activism is to contemplate the potential activist's challenge before it arises. A proactive approach is called for, where the board challenges its own strategies and stated goals, thinking more from an investor perspective. What have been the company's weaknesses and challenges? Why is it taking a different path to its peers, and how does the company intend to create value going forward?
- A considered, stress-tested and publicly-stated strategy, together with strong governance, including fixed timeframes for refreshing the board and key advisers, will position the company to fend off activist campaigns.
- Investor relations teams that actively and regularly engage with shareholders and have a line into the boardroom will better feel the shareholder 'pulse', allowing the company to address issues before they arise.

2018 – LOOKING AHEAD

“A company's best defence is a clear and compelling strategy, strong governance and regular and effective shareholder communications.”

Katherine Moir,
Corporate Partner,
London



5 PRACTICAL TIPS TO GET THE DEAL DONE

Careful and targeted planning will help companies be in the best position to respond to an activist campaign in the context of M&A.

Pre-empt the activist

Engage an external 'red team' (e.g. an investment bank; a law firm) to identify weaknesses in strategic plans/governance, assessing the business as an activist team might. Consider the analysis and respond to any weaknesses. With M&A, be clear on the strategic rationale and how it fits with the existing strategy. Consider whether, and on what basis, an activist would have reason to object to a transaction or the lack of one.

Know your shareholders

Monitor the shareholder base, including significant shareholders that appear on the register or increase their stake. If a known activist appears, research their investment thesis and tactics they have previously employed. Proactively engage with them as soon as you can. Even if they are not known activists, significant shareholders may become 'active' or may be sympathetic to an activist. Equally, known activists might sometimes not want to be 'seen' on the register.

Engage with shareholders

Engage regularly to monitor the shareholder 'pulse' and understand expectations before they escalate. The arrival of an activist should not be the trigger to start meaningful shareholder dialogue. Responses to issues discussed with shareholders should be recorded. If an activist campaign is launched, engagement with other significant shareholders is essential throughout.

Communicate deal rationale

As with all corporate actions, every M&A transaction should have a detailed communications plan, developed in conjunction with legal, financial, investor and public relations advisers. The strategic rationale and proposed valuation should be clear and transparent. Underselling or overpaying for assets can create major risks. Understanding existing shareholder concerns is also essential.

Have a response protocol

Prepare a response protocol the company can turn to when an activist acquires a stake or makes an unexpected demand. This might include a response committee and a set of communications guidelines with external advisers. The protocol should be flexible to deal with a dynamic, time-sensitive and potentially high profile situation. The presence of an up-to-date functioning protocol should help avoid knee-jerk defensiveness.

The background of the entire page is a collage of three flags: the United States flag on the left, the European Union flag in the center, and the Vietnamese flag on the right. The flags are shown in close-up, focusing on the stars and stripes, and are slightly tilted and overlapping.

3

TRADING PLACES



The state of play for foreign direct investment

Attitudes to foreign investment are in flux with some nations raising new barriers to address national security concerns and populist sentiment, having a particular impact on Chinese bidders. Meanwhile other countries are becoming more 'open' as they seek the benefits of an injection of overseas capital, technology and knowhow.

Regulatory restrictions are changing, but dealmakers must also be conscious of the influence of the public and political mood on the deal's likelihood of success.

Opportunities exist for buyers who can navigate the new and shifting barriers to entry. Agile buyers can also take advantage of opportunities in countries that are becoming more open.

-43%

Fall in value of Chinese outbound M&A in 2017 compared to 2016

US\$ 1.3bn

Chinese-backed Canyon Bridge's US\$ 1.3bn bid for Lattice Semiconductor Corp was blocked by President Trump on the recommendation of CFIUS in 2017

Blood plasma

Bid for German blood plasma products maker Biotest by China's Creat Group is facing CFIUS review, demonstrating the increased scrutiny of deals in industries not traditionally related to national security

+5%

Increase in foreign direct investment into China compared to 2016*

TRENDS WE ARE SEEING IN FDI

DIVERGING TRADE DYNAMICS: AMERICA TIGHTENS WHILE EUROPE FRAGMENTS AND CHINA OPENS

Cross-border investment is increasingly politicised, leading to diverging attitudes and rules.

- **‘America First’:** Both President Trump and Congress are seeking greater scrutiny of foreign buyers. The Committee on Foreign Investment in the United States (CFIUS), is following through on this by increasing reviews of certain foreign acquisitions, particularly when the target is a tech business or in a strategic industry. There have been two Presidential orders blocking foreign bids following recommendations from CFIUS (Aixtron SE/Fujian Grand Chip and Lattice Semiconductor Corp/China Venture Capital Fund) since December 2016 compared with just two in the previous 25 years. Increasingly CFIUS appears to be interpreting US national security concerns to include issues of competitiveness and innovation.
- **The picture in Europe:** Europe is characterised by a patchwork of national foreign investment laws and divergent attitudes to inbound investment. Despite calls by some countries for a pan-EU regime on foreign takeovers, the recently-proposed EU ‘framework’ would preserve this diverse set of rules and regulations.
- **Politics drive restrictions:** Governments are dealing with varying political and economic issues. The UK government is seeking to balance the need to remain ‘open’ while bolstering its powers to intervene in foreign takeovers on national security grounds. The Dutch government is considering similar measures in key sectors. In response to an influx of Chinese investment, Germany is seeking greater oversight, particularly where targets are advanced technology assets. The Italian government is using its ‘golden powers’ to block foreign deals.
- **Competition encourages opening:** At the same time, there is competition for foreign investment. Spain and several CEE countries are actively encouraging investment from Russia and China, exemplified by the ‘16+1’ alliance between 16 CEE countries and China.
- **China opening up?:** China is implementing new policies encouraging inward FDI. We consider these policies and their potential impact on M&A further on page 20.

“As CFIUS reviews become longer and more unpredictable, it is critical that deal strategies mitigate national security risks and the potential impact on deal timing and execution early on.”



George Kleinfeld,
US Regulatory Partner,
Washington DC

EUROPE'S PATCHWORK

Europe remains a region that is very open to FDI. However dealmakers should inform themselves of the diverging approaches and political sentiments which characterise individual countries, and the latest 'direction of travel'.



Czech Republic

Sensitive sectors:

Defence, telecommunications, energy

Remains very open to foreign investment despite calls for stricter rules. The Government has expressly voiced a preference for foreign investment in sophisticated sectors with higher added value.

Traditionally open, and staying that way



France

Sensitive sectors:

Defence, healthcare, infrastructure, energy

To date the Government has been flexible in the use of its powers to block foreign investment, limiting their use to defence assets or iconic national champions. However, recent proposals suggest increasing scrutiny in the future, notably in high tech activities.

Traditionally open, may be starting to close



Germany

Sensitive sectors:

Defence, energy, telecommunications

New laws have given the government greater powers to restrict foreign investment. This will result in greater scrutiny but is not expected to lead to more blocked deals, given potential political impact on desired FDI from China.

Traditionally open, now starting to close



Italy

Sensitive sectors:

Defence, transportation, TMT, energy

Government tends to favour foreign investment although this traditionally open approach has been criticised and now the Government has become more cautious, blocking the sale of Telecom Italia and Next Ingengneria.

Traditionally open, now starting to close



Netherlands

Sensitive sectors:

Telecommunications, infrastructure

While still very open, authorities are taking greater interest in foreign investment in strategic sectors and will likely introduce measures to tighten control on foreign takeovers in key sectors.

Traditionally open, may be starting to close



Poland

Sensitive sectors:

Defence, energy

Government is becoming more concerned about protecting national security and its national champions, so is becoming more interventionist. Recent appointment of a former bank CEO as prime minister may act as a counterweight to this shift.

Traditionally cautious, staying closed



Spain

Sensitive sectors:

Defence, telecommunications and media

Government tends to favour foreign investment and has limited powers to interfere. However it has voiced its disapproval over the privatised national champions to state-owned foreign buyers.

Traditionally open, and staying that way



UK

Sensitive sectors:

Defence, energy, transport, TMT

While Government has exercised 'soft power' to intervene in foreign takeovers, it is seeking greater powers to intervene formally on national security grounds and mandatory filings. Particular focus expected on critical infrastructure and advanced technology.

Traditionally open, may be starting to close

CHINA OPENS UP

THE CLIFFORD CHANCE PERSPECTIVE

While much attention is focussed on Chinese authorities' policies on outbound investment such as the Belt and Road initiative, the Chinese government's policies on encouraging inbound investment are also evolving. We look at the potential impact of current policies on M&A.

- **Managing capital flows:** China is advocating globalisation, but its inbound and outbound capital flows and foreign exchange reserves need to balance. As well as taking steps throughout 2017 to control excessive outbound investment, encouraging investment *into* China is now becoming a priority, supported by growing confidence in its own domestic businesses' ability to compete with new entrants. Whilst growth in inbound FDI remains slow, various policies encouraging inbound investment are leading to growth (+ 5% year-on-year for the first 11 months of 2017; a 10% increase in RMB terms)*.
- **Taking down barriers:** Chinese authorities are taking steps to open up the economy to overseas investment and M&A:
 - Liberalising the FDI regulatory regime: establishing foreign invested enterprises in China is becoming less burdensome and in normal circumstances no longer requires pre-approval.
 - Opening up financial sector to foreign capital: in November 2017 the Chinese government announced proposals to remove limits on foreign ownership in certain Chinese financial institutions. An initial relaxing of foreign ownership limits in securities, banking and insurance will lead eventually to the complete removal of these limits.
 - Tax incentives: new tax regulations encourage foreign companies to reinvest profits from their Chinese operations in China. Under the changes, foreign investors will be able to defer payment of withholding tax on dividends from China if such dividends are used in China on government-encouraged projects. The new regulations were issued in response to the recent US tax reforms which, many commentators believe, will lead to significant amounts of capital from US corporations flowing back to the US.
- **Strong interest in China:** Despite rising labour costs in China, the expected return of significant amounts of capital to the US referred to above and concerns from some foreign investors and businesses around the effectiveness of previous liberalising policies, investors continue to show interest in reaching the growing Chinese middle class, particularly in the life-science/healthcare, consumer goods, entertainment, and services (including financial services) sectors. M&A will play a key part in achieving this goal.

2018 – LOOKING AHEAD

“As government policies further incentivise FDI into China we expect to see strong interest in inbound M&A deals as well as strategic joint ventures in 2018, particularly in those sectors in which FDI is encouraged by these policies and which benefit from the fast growth of China’s domestic consumption capability.”

Glen Ma,
Corporate Partner,
Shanghai



*Source: Chinese Ministry of Commerce. Data relates to period from 1 January to 30 November 2017

5 PRACTICAL TIPS TO GET THE DEAL DONE

Cross-border dealmakers, particularly when investing into the US or Europe, should factor in the risks of government intervention and seek to mitigate them.

Identify sensitivities

What is considered to be an industry of strategic importance varies greatly and 'national security' is defined increasingly broadly in many countries. Review the target's activities, assets and IP. Assess their sensitivity (separately for each country of operation) to anticipate or pre-empt regulatory intervention.

Seek advice

Advisers with specialist knowledge of the regulatory regime and understanding of local sensitivities will help you to assess timing and execution risks before committing further resources and costs.

Engage early

Early engagement with key decision makers and influential voices within government stakeholders and regulators is essential to ensure that concerns are accurately understood and addressed. Any dealings with government officials or regulators should be carefully handled with advisers and appropriately recorded.

Create narrative

Implement the right media and lobbying strategy to emphasise the positive local impact of the deal. Ensure internal documents are consistent with this narrative, as they may be discloseable. It may, for example, be advisable to avoid unnecessary emphasis on a target business's contribution to critical infrastructure, plans to cut jobs, close facilities or export technology out of the home country.

Assess remedies

Consider whether formal or informal commitments may be necessary to secure clearance, or are desirable to mitigate public hostility; for example, maintaining or investing in jobs and facilities, or ring-fencing R&D, technology or sensitive information. Assess the cost of complying with such commitments as well as the risks of non-compliance.

4

SEEKING ALPHA

New moves in private equity

Traditional private equity operating models used by financial sponsors are under pressure.

Sponsors both old and new are in fierce competition for quality assets as vast sums of private capital have yet to be deployed and investors seek returns comparable to the past. In response, sponsors are innovating to generate returns and mitigate competition in auctions.

Sponsors are diversifying asset classes and geographies, strengthening their internal teams by hiring sector leaders to focus on operational value creation and adapting their funding structures, with an increasing use of credit instruments.

Those who succeed will emerge as the sector leaders and key participants in global M&A in 2018 and beyond.

US\$ 1trn

Undeployed capital or “dry powder” available to private equity fund managers hit the record US\$1 trn number at the end of 2017, up from US\$ 838bn in 2016¹

US\$ 24.6bn

Apollo Global Management closed its 9th fund at a record setting amount. In aggregate, private equity vehicles closed in 2017 raised US\$ 453 bn, an all-time record²

11.6x

Average valuation for high-end transactions (above \$250m) as a multiple of EBITDA. Rising year on year from 10.3x in 2014³

21%

Proportion of transactions with monitoring fees in 2017, down from 32% in 2016⁴

¹ Preqin

² Preqin

³ Pitchbook, 2017 average is to 15/12/2017

⁴ Pitchbook, 2017 average is to 15/12/2017

THE INDUSTRY TRENDS WE ARE SEEING

INNOVATION IN THE ALLOCATION OF CAPITAL

Early stage risk, minority investments, club deals, corporate carve-outs and sector focussed value creation are key features of an industry innovating to find returns in a low-growth environment. Differentiation and specialisation are critical to success for sponsors to mitigate the challenge of direct investment.

- With established funds setting fundraising records, debt readily available and limited partners moving into direct investment, the heightened competitive climate is putting the traditional '2 and 20' fee model under pressure. Given the deployment challenges, having access to capital is not enough.
- Sponsors are shifting to organise themselves by sector and regional lines, hiring experts to advise and focus on operational value creation. Larger, global players (increasingly operating by sector – e.g. Apax recently closed on a US\$1bn tech growth fund, or on regional platforms – e.g. KKR's recent US\$9bn Asian fundraising) can attain full coverage and competitive advantage over smaller outfits, helping to explain the record levels of investment in more established funds. Some sponsors are appointing C-suite executives with experience at sector relevant multinationals to the boards of portfolio companies. Interestingly, the adoption of specific investment criteria could be seen as a challenge to the direct investment model, where greater concentration risk through exposure to a single asset is a key feature.
- Through sector focus sponsors can target early stage minority investments, which allow for flexibility, potential 'buy and build' strategies and put the sponsor in prime position to acquire control should the business grow. 'Platform' strategies can also be adopted, allowing for the ring-fencing of assets. Liability is segregated by structural separation, so that individual asset under-performance does not pollute the wider portfolio, but returns are aggregated. Renewable energy projects lend themselves to a platform approach as sponsors seek to take varying levels of operational risk across projects and geographies.
- Corporate carve outs are of interest to sponsors seeking to take advantage of the opportunities as activist investors apply pressure to businesses to divest divisions and boost shareholder returns. Well known activists, such as Elliott, are establishing private equity style funds to benefit from opportunities they are creating. PE activity in some markets, for example Japan, is being primarily driven by such activity.

“Sponsors are adapting to win. Investing strategies focus on hedging downside, the popularity in club deals can be explained by sponsors seeking to mitigate equity concentration across the fund, and fund investment theses are increasingly specific to differentiate and enhance marketability to limited partners.”



Andrew Whan,
Head of Corporate,
Asia Pacific

DEAL INSIGHTS

INNOVATION IN THE SHIFTING MARKET



Platform

Acquisition by a consortium led by Global Infrastructure Partners of Equis Energy for US\$ 5bn*

- The deal is a record for the renewable energy industry and demonstrates the benefit of a platform development approach. Equis Energy's portfolio of assets includes solar, wind and hydroelectric power operations in Australia, Japan, India, Indonesia, the Philippines and Thailand.
- Equis Energy, which is developing one of the largest solar plants in Australia, has over 180 assets in operation, construction and development with capacity of more than 11 gigawatts. Global Infrastructure Partners III fund is buying Equis Energy with investors including Public Sector Pension Investment Board and CIC Capital.



Partnership

Minority investment of GBP150m by Inflexion into Radius Payment Solutions*

- The transaction values the company at GBP800m.
- Inflexion's Partnership Capital fund is an example of a bespoke fund, which focuses on strategic minority investments offering support and investment expertise from a position of influence rather than control.



Buy and Build

Minority investment by Permira into Alter Domus and subsequent acquisition of Cortland Capital Markets Services*

- Alter Domus, a leading provider of Fund and Corporate Services, signed a deal to acquire Cortland Capital shortly following an announcement that it had secured significant investment from Permira.
- Permira's investment demonstrates a traditional buy-out fund taking on a minority stake, supporting the business through its geographical expansion and growth ambitions.



Club

Acquisition by a consortium of Cinven and Bain of Stada for €4.1bn*

- The sale of Stada, the German maker of generic Viagra, is one of Europe's two largest buyouts in the last four years, behind the acquisition of Nets A/S, Scandinavia's largest payments processor, by Hellman & Friedman for US\$ 5.3bn.
- Club deals such as these are evidence of sponsors teaming up to spread their risk and acquire assets that may have otherwise been out of reach due to the size of equity commitment.



Carve out

Acquisition by a consortium led by Bain of Toshiba's NAND flash memory chip unit for ¥2.1trn

- An example of a growing trend of corporate carve outs being targeted by private equity houses, including: CVC acquiring Teva Pharmaceutical's women's health assets outside the US for US\$ 1.4bn; KKR recently signing a deal to acquire the spreads business of Unilever for €6.8bn; and under pressure from activist investors, Akzo Nobel is seeking to sell its speciality chemical business for around €9bn.

* Clifford Chance advised on each of these transactions.

STRUCTURAL SHIFTS AND INVESTOR FIGHTBACK

THE CLIFFORD CHANCE PERSPECTIVE

Whilst acquisition finance is a keystone of the private equity model, we see sponsors increasingly utilising debt within their funds to enhance fund performance and maximise deal competitiveness. For some investors this is unwelcome - we see growing resistance to the use of such debt products.

- For sponsors, fund-level borrowings are attractive from a marketability and returns perspective. We see two broad types of structures:
 - Capital call facilities (secured against investors' uncalled capital). Anecdotally known as 'look-up' or 'bridge' facilities, they are inexpensive, short term and principally used to bridge capital calls. The attraction to funds is both practical (reducing the frequency/administration of capital calls) and accretive to the economics of the fund's performance. This is good news when fundraising.
 - Asset based/NAV facilities (secured across the fund's investments) and Holdco/PIK facilities (secured against individual investments). Anecdotally known as 'look-down' facilities, they are long term, more complex and more expensive. The benefits for the fund are the additional leverage in the structure, which can enable the ability to go higher when pricing deals and achieving liquidity without an exit, through a recapitalisation.
- While the fund's key performance measure (the internal rate of return) is enhanced by delay in calling capital from investors, the absolute return to investors may not be. Further, a reduction in the frequency and size of capital calls can defer and reduce the accrual of investors' return. In that context, investors are fighting back, in some cases requiring that capital is considered called when bridge facilities are drawn and remains outstanding for long periods. Some are pushing to cap the quantum of fund borrowings and the term.
- Co-investors with sponsors utilising look-down Holdco/PIK facilities should also be aware of this. For example, the terms of shareholders' agreements, including change of control and transfer provisions, will need to cater for enforcement by a secured PIK/Holdco lender.

2018 – LOOKING AHEAD

“The challenge to unlimited use of fund leverage derives from investor concerns on risk and returns. Ramping up direct investment capability, classic fund investors are now competitors with sponsors for deals without the private equity fees and carried interest. Together with the competitive environment, these factors heap pressure on the traditional PE model.”

Andrew Husdan,
Finance Partner,
London



5 PRACTICAL TIPS TO GET THE DEAL DONE

Dealmakers need to be open and flexible in approach when executing M&A in the current landscape. Creating opportunities which welcome the capital on offer from sponsors will engender an efficient competitive process.

Secure influence

Maximising governance when investing as a minority is critical. Downside economic protection can also include a liquidity preference. Pre-emption rights ensure the ability to participate in future funding rounds.

Plan a clean separation

Work with your legal and financial advisers to ensure the business to be sold is an independent, standalone unit or, if it is not, has a mechanism to obtain the support needed. Allocation of assets and dependence on any corporate services should be identified and diligenced at an early stage. Planning may be difficult with activist shareholder pressure to carve out divisions quickly. It is important to work through complex transitional service arrangements to ensure the cost and practicality of post deal services are factored in.

Address impact of debt

Sponsors seeking flexible terms enabling them to incur leverage at all levels in the structure should address the impact of utilising that debt on their investors and co-investors. If used correctly, these credit instruments can provide significant operational flexibility as well as increase the competitive advantage of sponsors.

Draft for tomorrow

With club deals and minority investments being features of the competitive landscape, it is important that any consortium agreements and bid conduct terms allow a sponsor to take advantage of opportunities that may arise quickly and efficiently. Information rights, pre-emption rights, financing, exit and cooperation provisions and confidentiality obligations should cater for multiple eventualities.

Forsee future disruption

When scoping diligence it is important to evaluate the development actions in the business plan by reference to future disruptive change. The impact of, for example, GDPR on the planned use of data and any technological enhancements must not be ignored. The implementation of MIFID II and developments in antitrust laws should also be considered.

5

GLOBAL M&A DATA

Outlook for 2018

Using insight and deal intelligence from across our global network and year-end data from Mergermarket, we analyse the key trends and drivers for global M&A in 2018.

Overall M&A deal values globally are relatively flat - down 3% on the previous year - but with pockets of activity growth in certain hotspot locations and industries.

With growing confidence in boardrooms and amongst dealmakers, a positive outlook for the world economy, a stable oil price, strong company balance sheets and ample dry powder, the initial indications are that 2018 will be a busy year for M&A. Uncertainties around the impact of mid-term elections in the US, rising interest rates, trade disputes and geopolitical flare-ups may throw up some speed bumps but at this point we see a positive year ahead.

+103%

Increase in value of inbound M&A into Japan compared with 2016, illustrating growing confidence in Japan's economy following Shinzo Abe's re-election and ongoing economic reforms

US\$ 18.8bn

Sempra Energy's acquisition of Energy Future Holdings, the largest deal in the Energy sector in 2017

+23%

Increase in value of M&A within Latin America in 2017 compared to 2016

US\$ 2.6bn

Vodacom of South Africa's acquisition of a 35% stake in Kenya's Safaricom, the largest deal in Africa in 2017 outside of the Energy sector

GLOBAL M&A DATA SET

WE IDENTIFY TRENDS, LOOKING AT DEAL VALUE FOR 2017 AS COMPARED TO 2016



Global M&A activity is down 3% by value, totalling US\$ 3.16trn for the year. Q4 was the strongest quarter of the year with US\$ 896bn worth of deals.



European M&A is strong with deal value up 14%, driven by intra-European M&A activity (+53%) and inbound deals from the US (+8%). This helps counter-balance a 52% fall in Chinese M&A into Europe. All other major regions are seeing subdued activity as compared to 2016. US M&A is down 14%.



Cross-border M&A is seeing a significant shift, with inter-regional deals now comprising 26% of global deal value, down from 30%, partly due to the decline in Chinese outbound activity in 2017. Asia-Pacific is the only region to see increased inbound activity into the region.

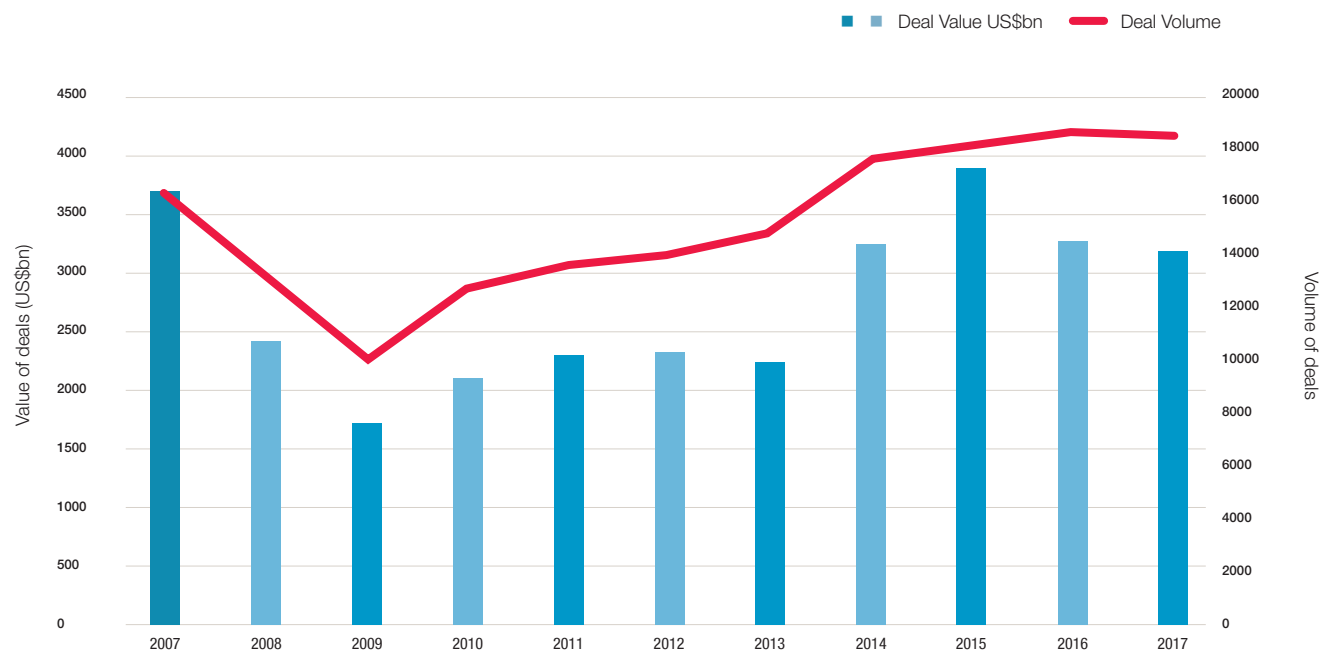


Consumer, Retail and Leisure is the hottest sector – up from 10% to 15% share of total global activity, as a result of megadeals such as BAT/Reynolds American and Amazon/Whole Foods.



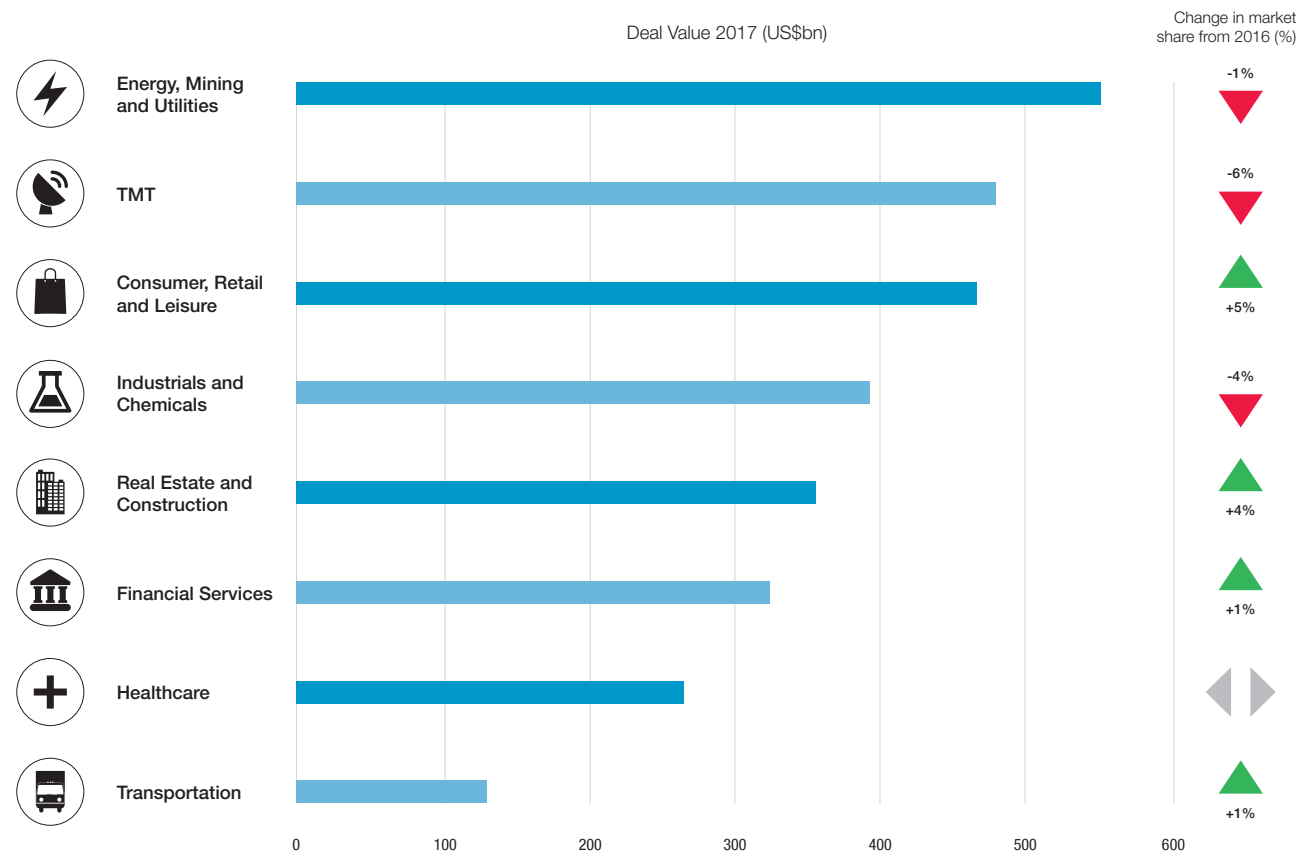
The private equity market remains strong with sponsor-led M&A totalling US\$ 874bn – accounting for 28% of global deal value. Ever-growing levels of capital need to be deployed and corporate carve-outs are being targeted. The €4.1bn Bain/Cinven buyout of STADA is Europe's largest in 5 years, an example of returning public companies to private ownership.

GLOBAL M&A ACTIVITY



Source: Mergermarket

SECTOR TRENDS



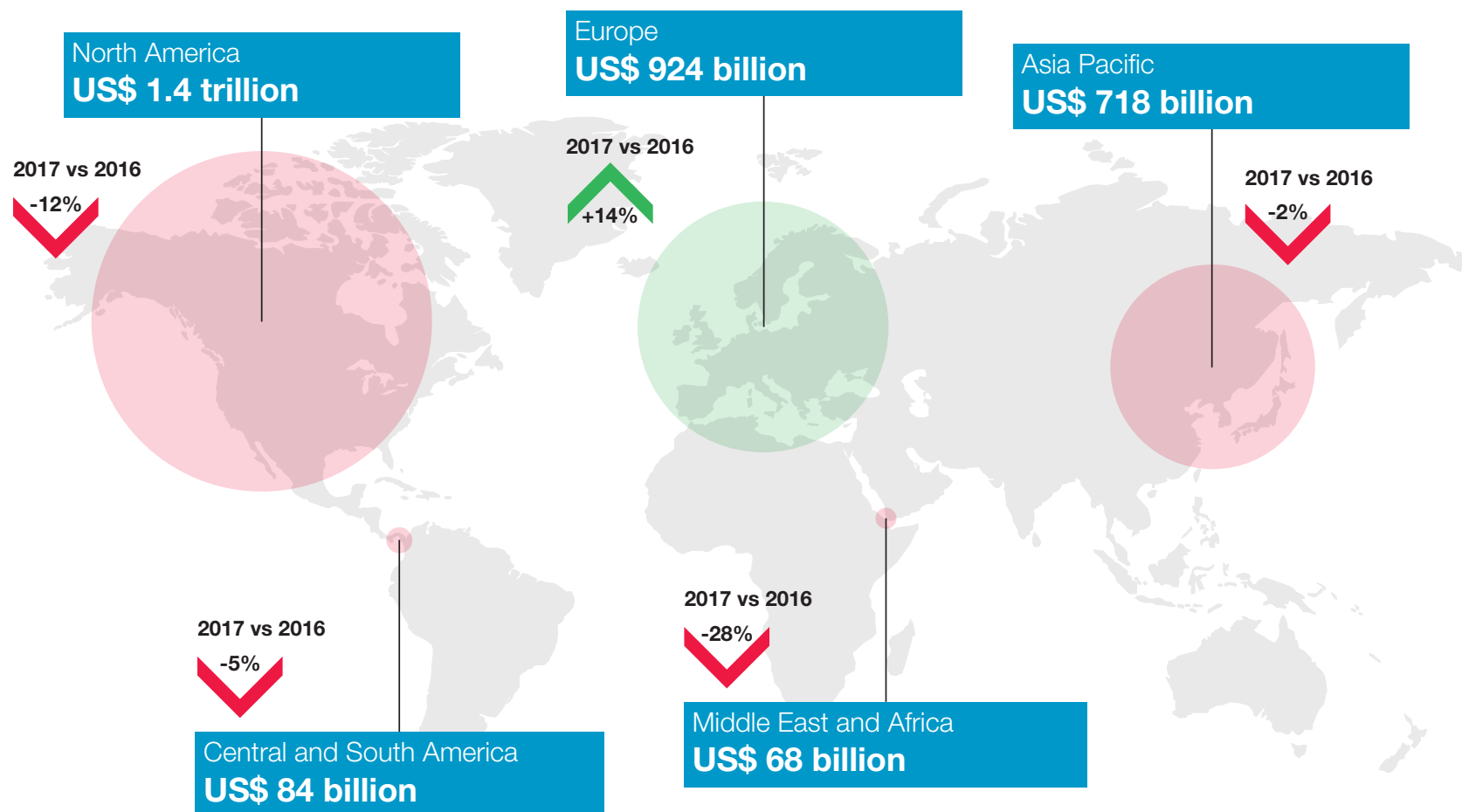
“It is crunch time for traditional retailers, many of whom now face a pressing choice between rapid transformation for the digital age, a major strategic pivot or potential extinction. These high stakes will drive M&A in the retail and consumer sectors, including M&A between traditional CG&R companies and tech companies.”

Dessislava Savova,
Head of CG&R, Paris



GLOBAL M&A DATA SET

REGIONAL TRENDS



Source: Mergermarket

Note: Interactive maps showing investment flows into and out of each region are available on the Clifford Chance Global M&A Toolkit - www.cliffordchance.com/GlobalM&AToolkit

US

- Political uncertainty slowed US M&A activity early in 2017. Activity picked up with the three largest deals of 2017 occurring in Q4. Several significant deals involving US targets failed due to antitrust scrutiny (Anthem/Cigna); CFIUS concerns (Lumiled/GO Scale); and shareholder activism (Huntsman/Clariant). US outbound M&A increased, particularly targeting Europe (Praxair/Linde). Disruption contributed to increased cross-sector convergence in strategic M&A activity (AT&T/Time Warner).
- The enactment of the Tax Cuts and Jobs Act in December ended uncertainty surrounding tax reform. The new law will revamp the US international tax system and may well spur US M&A activity by raising after-tax rates of returns on investments in US companies or providing US companies with liquidity by accessing the cash of their foreign subsidiaries.

LATIN AMERICA

- Although M&A is down 5%, a modest resurgence was evident in the final months of 2017, resulting from government measures to stimulate demand and increasing commodity prices. Hotspots include Argentina, Mexico and Brazil, with strong activity in the TMT and Consumer sectors. In Energy, Statoil's US\$ 2.4bn acquisition of Petrobras' stake in the Roncador oil field in Brazil is notable.
- Looking ahead, the impact of Brazilian and Mexican elections and developments in the US-Mexican trade relationship are key areas to watch. Proposed economic reforms in Brazil hold promise, while M&A prospects for Argentina also appear strong (particularly in the Energy, TMT and Consumer sectors).

EUROPE

- Despite political volatility, European M&A is strong currently, up 14% year-on-year. This growth is largely the result of a 53% increase in intra-European M&A, which counter-balances a 52% fall in M&A from China.
- The German M&A market continues to outperform at US\$ 131bn (+45%), with notable Industrials/Chemicals deals in 2017 (Bain/Cinven buyout of STADA, Praxair/Linde). The UK has the highest deal value total (US\$ 202.6bn), as foreign acquirers take advantage of Brexit uncertainty and weak sterling. Spain is seeing particularly strong inbound M&A, up 176% to US\$ 113bn in 2017, almost matching Germany (US\$ 114.6bn).

AFRICA

- 2017 has been a challenging year for domestic and inbound M&A. Disputed elections in Kenya, new protectionist legislation and FX depreciation across the continent dampened investment activity, particularly from Europe. Investor confidence is now returning to markets such as Nigeria, Egypt and Francophone West Africa where governments are seen to be actively managing political, economic and other structural issues.
- Africa's infrastructure deficit continues to drive activity in the Energy, Mining and Telecoms sectors, where sales between global strategics comprise the continent's largest deals. Africa's rush to embrace tech is creating new business models and M&A opportunities in Fintech, Education and Pharma.

ASIA PACIFIC

- M&A deal value is relatively flat (+2%), with growth in inbound activity from Europe (+26%) and the US (+11), and marginally lower levels of intra-regional activity. Previous outbound investment flows from Japan and China are in part being redirected within the Asia-Pacific region. Significant activity in tech includes SoftBank/Didi Chuxing in China and SoftBank/Flipkart and One97 in India.
- Australian M&A is up 31%, with strong activity in Financial Services, Healthcare, Agribusiness and Renewables. Ongoing privatisation will lead to further infrastructure assets coming to market.

MIDDLE EAST

- Overall deal values are down 12%, reflecting prolonged weakness in oil prices, regional tensions, tighter fiscal policies and ultimately a 'wait and see' attitude by many investors. Outbound M&A is up 40% as investors seek greater returns and diversification overseas.
- Within the region, M&A activity in Industrials, FIG, Healthcare, and Tech remains strong, while demand in Retail, Entertainment and Real Estate has slackened. The outlook for 2018 remains positive as political and economic reforms, particularly in Saudi Arabia, seek to increase investor confidence and drive deal-making.

GLOBAL M&A TOOLKIT

Clifford Chance Global M&A Toolkit

The essential interactive resource for anyone involved in M&A transactions.

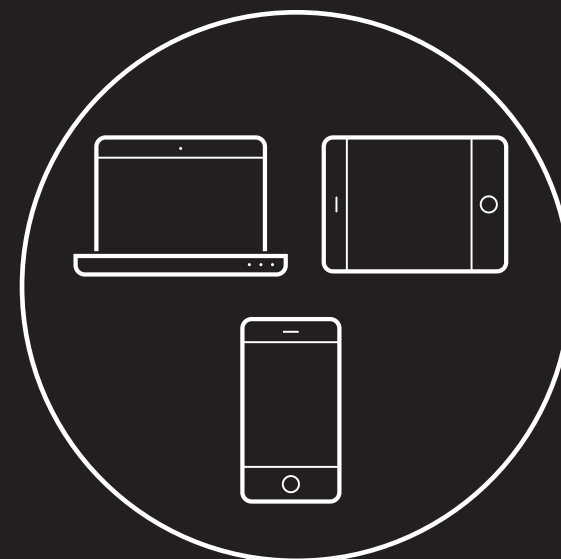
The Clifford Chance Global M&A Toolkit comprises a growing collection of web-based transaction tools, video content and in-depth analysis of the most important market and regulatory developments in M&A regimes across the globe.

www.cliffordchance.com/GlobalM&AToolkit

Global M&A Trends: Interactive investment flow maps

Our interactive maps show current M&A flows into and out of each major investment region of the globe giving you insights into the latest trends in cross-regional M&A. The maps are easy to use, simple and effective. Available through the Global M&A Toolkit at:

www.cliffordchance.com/GlobalM&ATrends



Editors for this publication

CHRISTOPHER SULLIVAN

T: +44 20 7006 5050
E: christopher.sullivan@cliffordchance.com

JOHN COLEMAN

T: +44 20 7006 2861
E: john.coleman@cliffordchance.com

ISABELLE HESSELL TILTMAN

T: +44 20 7006 1681
E: isabelle.hessell-tiltman@cliffordchance.com

JENNIFER MBALUTO

T: +44 20 7006 2932
E: jennifer.mbaluto@cliffordchance.com

EDWARD FREEMAN

T: +44 20 7006 2277
E: edward.freeman@cliffordchance.com

MARY BARTLE

T: +44 20 7006 2362
E: mary.bartle@cliffordchance.com

ERIKA BUCCI

T: +1 212 878 8142
E: erika.bucci@cliffordchance.com

STEFAN BRUDER

T: +49 697199 1771
E: stefan.bruder@cliffordchance.com

BRIAN HARLEY

T: +852 2826 2412
E: brian.harley@cliffordchance.com

OUR INTERNATIONAL NETWORK

GLOBAL

GUY NORMAN

T: +44 20 7006 1950
E: guy.norman@cliffordchance.com

UNITED STATES

DAVID BRINTON

T: +1 212 878 8276
E: david.brinton@cliffordchance.com

LATIN AMERICA

JAVIER AMANTEGUI

T: +34 915 907 576
E: javier.amantegui@cliffordchance.com

BRAZIL

ANTHONY OLDFIELD

T: +1 212 878 3407 / +55 11 3019 6010
E: anthony.oldfield@cliffordchance.com

ASIA PACIFIC

ANDREW WHAN

T: +852 2825 8903
E: andrew.whan@cliffordchance.com

JAPAN

TATSUHIKO KAMIYAMA

T: +81 35561 6615
E: tatsuhiko.kamiyama@cliffordchance.com

SINGAPORE

VALERIE KONG

T: +65 6410 2271
E: valerie.kong@cliffordchance.com

AUSTRALIA

LANCE SACKS

T: +61 2 8922 8005
E: lance.sacks@cliffordchance.com

CHINA

TERENCE FOO

T: +86 10 6535 2299
E: terence.foo@cliffordchance.com

INDIA

NEERAJ BUDHWANI

T: +852 2826 2428
E: neeraj.budhwani@cliffordchance.com

MIDDLE EAST

MOHAMMED AL-SHUKAIRY

T: +971 4 503 2707
E: mo.al-shukairy@cliffordchance.com

AFRICA

SPENCER BAYLIN

T: +44 20 7006 1519
E: spencer.baylin@cliffordchance.com

TURKEY*

ITIR ÇİFTÇİ

T: +90 212339 0077
E: itir.ciftci@yeginciftci.av.tr

CENTRAL AND EASTERN EUROPE

ALEX COOK

T: +420 22 255 5212
E: alex.cook@cliffordchance.com

RUSSIA

MARC BARTHOLOMY

T: +7 495 660 8006
E: marc.bartholomy@cliffordchance.com

FRANCE

LAURENT SCHOENSTEIN

T: +33 14405 5467
E: laurent.schoenstein@cliffordchance.com

GERMANY

THOMAS KRECEK

T: +49 21 1435 55468
E: thomas.kreck@cliffordchance.com

NETHERLANDS

HANS BEERLAGE

T: +31 20711 9198
E: hans.beerlage@cliffordchance.com

ITALY

UMBERTO PENCO SALVI

T: +39 028063 4241
E: umberto.pencosalvi@cliffordchance.com

SPAIN

JAVIER GARCÍA DE ENTERRÍA

T: +34 915 904 102
E: javier.garciadeenterria@cliffordchance.com

LUXEMBOURG

CHRISTIAN KREMER

T: +352 485050 201
E: christian.kremer@cliffordchance.com

UNITED KINGDOM

MARK POULTON

T: +44 20 7006 1434
E: mark.poulton@cliffordchance.com

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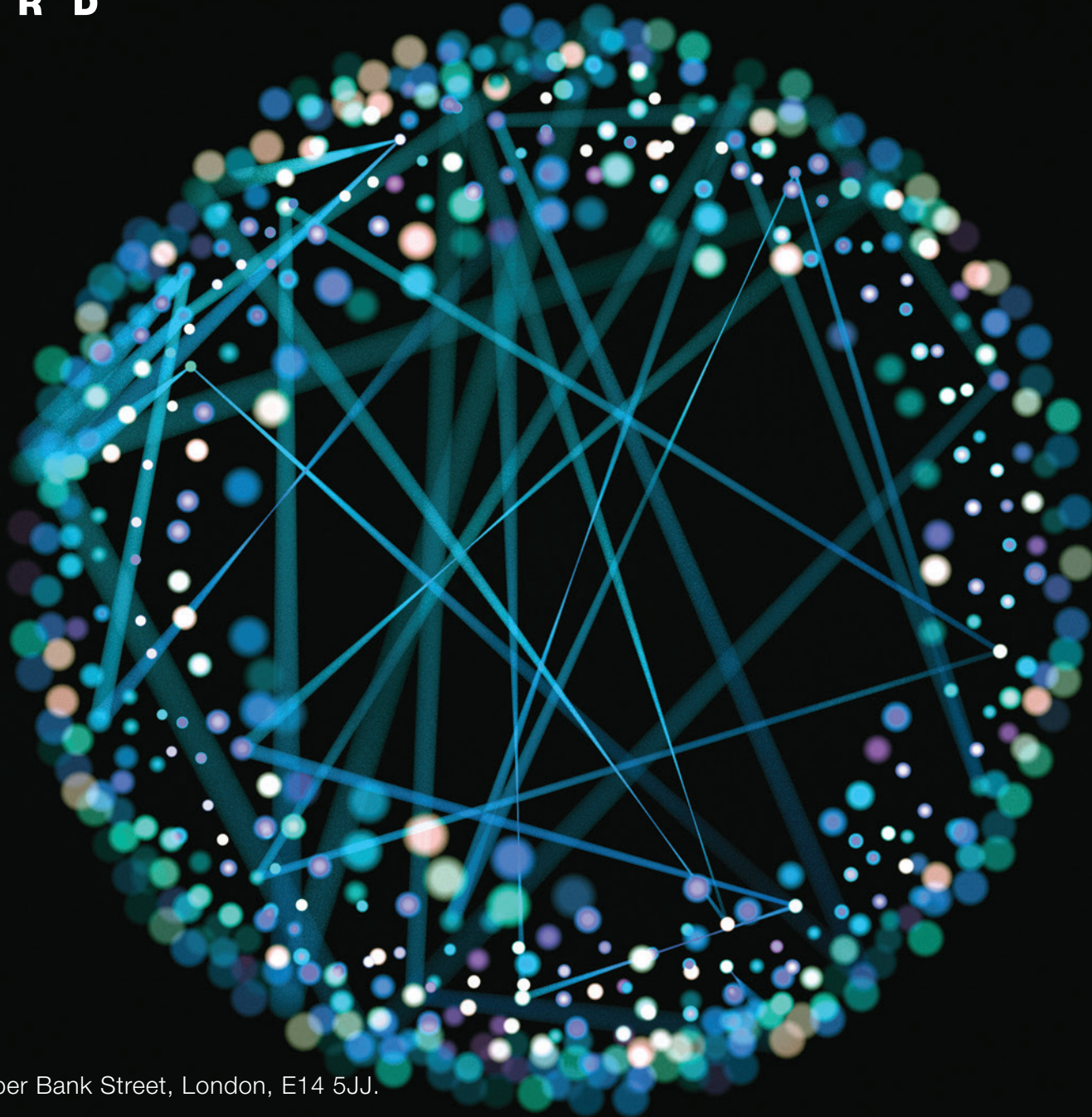
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