Regional Focus: Europe

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UNITED KINGDOM

M&A Update

M&A activity in the U.K. was, under the circumstances, relatively robust in 2016, albeit not as strong as in 2015. Deal volume was down, in large part due to political uncertainty surrounding the June 2016 Brexit vote and the November U.S. election. Although this uncertainty was partially offset by the devaluation of the pound following the Brexit referendum, which made U.K. assets relatively cheaper, and while strong inbound interest from both the U.S. and Asia remains, the overall value of U.K. M&A activity relied on a smaller number of relatively high-value deals, such as the London Stock Exchange Group/Deutsche Börse merger and SoftBank's acquisition of ARM Holdings.

For 2017, insofar as domestic activity is concerned, uncertainty as to the structure and timetable for Brexit is expected to exert downward pressure, although the continued availability of debt and (if the markets stay strong) equity financing should offset that to some extent.

From a cross-border perspective, the corrections in the values of the pound and, to a lesser extent, the euro have reduced the apparent cost of European assets for non-European acquirers. This should result in a continued increase in inbound interest, though that interest has not yet translated into significant deal volumes in the U.K. This may in part be because, although in the short term the reduction in value of the pound has lowered the cost of investment in the U.K. for international acquirers and increased the value of exports, the macroeconomic consequences may be unclear for a while. Markets have responded to the decline in the pound with a material rise in market capitalization of U.K.-listed companies that have international exposure. Additionally, imports are commensurately more expensive, and the future levels of tariffs are unknown. Finally, uncertainty surrounding the U.K.'s ability to strike favorable trade deals with other non-EU countries remains.

Other macro factors will likely have a greater specific impact on individual industries. For example, regulatory and financial pressures on the financial services sector, in particular on mixed financial businesses, are likely to lead to pressure for disaggregation, while the settlement of long-running disputes may make some assets more sellable. In the insurance industry, specifically, market fundamentals that have underpinned activity in the sector remain in place. Meanwhile, Solvency II, which regulators intended to reduce regulatory risk by harmonizing capital requirements, has been in place for more than a year, and the impact of the changes to regulatory requirements on potential targets is becoming clearer, as most insurers have reported information showing the effect on their capital positions. Thus, there is greater clarity for companies in buying mode and diversified groups in determining where their capital can be most effectively deployed. This is likely to lead to realignment and consequential transactional activity on both the buy and sell sides this year. Many who have carried out significant analysis and planning in connection with potential deals now appear to be moving toward a position where they consider the consequences of Brexit manageable.

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The broad shape of Brexit is starting to become clearer. Prime Minister Theresa May provided clarity as to the U.K. government's intentions in a speech on January 17, 2017. (See our January 20, 2017, client alert "UK Prime Minister Outlines Objectives for Exiting the EU.") We now know the U.K. government will have to leave the single European market. Additionally, in order to negotiate its own trade deals, the U.K. also will have to leave, either wholly or substantially, the customs union. The U.K. government intends to negotiate a trade deal with the EU and incorporate arrangements beneficial to specific sectors, such as retaining some version of existing "passporting" rights for financial services institutions, with automotive manufacturing also likely to be a hot topic. While the U.K.'s starting point is coming into focus, however, there is little concrete information on what to expect at a granular level and what both the U.K. and the EU would consider acceptable. Companies across sectors should expect continuing uncertainty while the overall position becomes clearer.

President Donald Trump said the U.S. would work to complete a new trade deal with the U.K. quickly once he assumed office, a suggestion that is being cautiously welcomed — provided the outcome isn't shaped by the more aggressively protectionist positioning that President Trump has at times adopted. The evolution of this and other trade deals and what, precisely, Prime Minister May's vision of a "global Britain" means will likely be dominant factors this year.

Cooperation With Other Nations, Use of DPAs May Drive Investigation Increase

When the U.K.'s Bribery Act came into effect in July 2011, many expected U.S.-style Foreign Corrupt Practices Act enforcement to become more prevalent in Britain. And while the Serious Fraud Office (SFO) has brought only four actions against corporations since the Bribery Act's enactment, there are indications that investigations are on the rise. One reason for the low number of investigations so far is that the Bribery Act does not apply to conduct before July 2011. From detection through investigation to enforcement, bribery proceedings can take several years, making it likely that we will see a significant number of cases in the future.

A higher volume of whistleblower activity due to such developments as enhanced whistleblower protections, an increased awareness and acceptance of "speaking up," and significant journalistic coverage of high-profile investigations like the Panama Papers also could drive an increase in enforcement activity. Additionally, increased cooperation with other national regulators, both formal and informal, has improved the speed and effectiveness with which prosecutors are able to obtain evidence of corporate misconduct from abroad, including through coordinated searches in multiple jurisdictions.

While the SFO has long worked closely with the U.S. Department of Justice, it now also collaborates with a growing number of other regulators in cross-border investigations. For example, the Alstom case involved cooperation between prosecutors in the U.K., Switzerland and Hungary. In September 2014, the SFO brought corruption and conspiracy charges against Alstom Network UK Ltd relating to transport projects in India, Poland and Tunisia. Two company executives also were charged with the same offenses. In December 2014, the SFO brought further charges — under the Prevention of Corruption Act 1906 and the Criminal Law Act 1977 — against Alstom Power Ltd and two executives for offenses committed between 2002 and 2010 related to the refurbishment of the Lithuanian Power Plant.

The U.K. also has made significant changes to its criminal justice system to try to increase its prosecutions of corporations for serious crimes. These changes include clarifying sentencing guidelines for corporate corruption and introducing deferred prosecution agreements (DPAs). DPAs, which are common in the U.S., encourage companies to cooperate with the government in cases involving economic and financial offenses. If a company's conduct meets defined criteria and it agrees to certain conditions, including the payment of financial penalties, a company may elect to use a DPA to avoid prosecution. In contrast to the U.S., the entire DPA process is subject to judicial oversight and approval, which provides greater insight into the decision-making of the judges and the prosecution, as well as a transparency around the factors that will be taken into account. In the Rolls Royce DPA announced in mid-January 2017, the judge went to great lengths to explain the company's "extraordinary cooperation," even though other aggravating features of its conduct tended to support a prosecution.

FRANCE

M&A: Domestic Activity Up, Cross-Border Down in 2016

The French M&A market experienced an 8.1 percent increase in deal value in 2016 (compared to 2015), reaching €76.2 billion on 869 deals, 75 more than 2015, according to Mergermarket. The most active sectors in 2016 were financial services; pharmaceutical, medical and biotechnology; energy, mining and utilities; industrial and chemicals; and real estate. However, such statistics are impacted by the €18.5 billion Crédit Agricole/Sacam transaction (a transfer of a minority interest in the regional banks to Crédit Agricole's parent company) — without it, deal value decreased by 18 percent compared to the previous year.

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Domestic M&A accounted for the highest deal volume (€41.9 billion, up 102.1 percent), while inbound M&A experienced a 31 percent decrease at €34.3 billion, a third of which was the €11.4 billion exchange of assets between France-based Sanofi and Boehringer Ingelheim of Germany. Chinese buyers continue to show interest in inbound M&A, especially in the hospitality business, with deals such as Jin Jiang's acquisition of the Louvre Hotels Group and of a significant interest in hotel group Accor.

Outbound M&A by French companies reached €43.7 billion in 2016, a 1.2 percent decrease compared to 2015. Transactions included the acquisition of U.S.-based WhiteWave by Danone (€11.3 billion), the merger between Technip and U.S.-based FMC Technologies (€4 billion), the acquisition by Accor of Canada-based Fairmont Raffles Hotels International ($2.7 billion) and the recently announced acquisition by car equipment manufacturer Valeo of the Japanese company Ichikoh. Low interest rates and easy access to funding could spur French companies in search of growth to pursue outbound opportunities in 2017, especially in the telecommunications, media and technology sectors.

Private equity continues to represent a significant portion of the market, with private equity buyout and exit transactions involving French companies totaling €25.2 billion. In some instances, private equity and private equity-led companies have competed head to head with corporates for significant businesses, as in aircraft engineering company Safran's auction of Morpho, a biometric identification business. Advent International-sponsored Oberthur eventually won the auction over Gemalto; both are digital security companies.

Implications of French Elections in 2017

Historically, election years have not been good for M&A in France, which will hold presidential elections in May and parliamentary elections in June, as people tend to wait for the policies of the new administration to become clear before making business decisions. Transactions involving companies where the French state has a significant interest are likely to be the most affected. Material transactions in strategic sectors, for example those in which the foreign investment control regime applies, may be perceived as more difficult.

Several presidential candidates, such as conservative and pro-business François Fillon (the right-wing candidate) or social-liberal Emmanuel Macron (the center candidate), propose to liberalize the French labor market as well as reduce taxation on companies and individuals. Fillon has indicated that he would promote France's disposal of government-owned equity interests that are perceived as nonstrategic. This may prompt companies in which such interests are held to pursue strategic partnerships as a way to secure a stable shareholder base, thus spurring M&A activity.

With the parliamentary elections, it is possible that the new legislature could simplify the M&A process in France, which remains unnecessarily burdensome in certain aspects. For example, cross-border deals involving a French company require a time-consuming tax-ruling process, the legality of which is currently being challenged under European Union law.

France Looks to Attract Business After Brexit

Brexit has had minimal impact on French transactions, including those with a U.K. component. For example, the Technip/FMC Technologies merger, which was announced prior to the Brexit vote, was completed on January 16, 2017. It combined the French- and U.S.-based companies into a new U.K. entity, with completion pursuant to the original structure unaffected by the Brexit vote. Likewise, Nissan, which has a strategic alliance and shares its CEO with French company Renault, has confirmed its plan to manufacture its successful Qashqai SUV in the U.K. as long as the U.K. government gives certain assurances. In the financial sector, French banks have confirmed they have no plans to materially reduce their presence in the U.K.

On the other hand, France is keen on attracting businesses currently located in the U.K., as well as foreign investors already in the U.K. or considering investments there. The current French government has plans to reduce its corporate tax rate progressively to 28 percent and to extend the tax favorable "impatriation" regime, which provides benefits to non-French employees relocated in the country, from five to eight years. France also has favorable tax breaks for research and development ("crédit d'impôt recherche"), which it is trying to promote to attract research programs.

Additionally, France hopes to attract more business from financial institutions that do business across Europe from London and it is advocating in the EU for the relocation of the euro-settlement of transactions in the eurozone.

Enforcement and Regulatory Developments

France has adopted a new anti-corruption law, "Sapin II," which was inspired by the U.S. Foreign Corrupt Practices Act and the U.K. Bribery Act, and which has extraterritorial implications. It requires that large French companies, including their foreign subsidiaries, implement a compliance program; and it allows for the prosecution of acts of corruption committed abroad by French nationals or by persons who ordinarily reside in France or carry out all or part of their economic activity in France. In addition, Sapin II has created a new French anti-corruption authority ("Agence française anti-corruption") that is responsible for monitoring compliance programs and ensuring that French companies subject to foreign investigations comply with the

French blocking statute (“loi de blocage”), which may block discovery requests from foreign authorities. With regard to sanctions for acts of corruption, the law has created a settlement agreement procedure (“convention judiciaire d’intérêt public”) similar to the deferred prosecution agreement used in the U.S.

French authorities responsible for controlling direct foreign investments in France are focusing increasingly on economic and technological security issues: preservation of essential infrastructure and sensitive technologies, access to vital resources, energy independence, protection of strategic sectors and cybersecurity.

French-listed corporations and their executive officers will continue to face stricter governance requirements and best practices. The corporate governance code for listed corporations (“code de gouvernement d’entreprise des sociétés cotées AFEP-MEDEF”) was amended in fall 2016. The strategic role of the board of directors has been heightened, the criteria used to assess directors’ independence have been specified and the rules governing executive compensation have been strengthened. Meanwhile, under Sapin II, the compensation of executive officers of French-listed companies is now subject to prior authorization by the shareholders, and subsequent shareholder approval of the compensation effectively paid is now compulsory. Furthermore, financial disclosure requirements also have been strengthened, in accordance with the Market Abuse Regulation and as a result of the stricter position taken by the French financial markets authority (“Autorité des marchés financiers”) with regard to issuers’ permanent disclosure obligations. These changes have occurred in a context characterized by the development of shareholder activism in France — though not at the levels found in the U.S. and the U.K. — and by increasing shareholder engagement.

GERMANY

M&A: Political Influences, Governance Requirements, Activism and China

German M&A activity in 2016 was broadly in line with prior years, except for a degree of softening in the third quarter of the year due to general uncertainty regarding economic prospects in Europe and Asia as well as political factors such as Brexit, the U.S. election and the constitutional referendum in Italy. Despite unexpected results in all but the Italian referendum, and recognizing that the outcomes in the U.K. and the U.S. are expected to result in changes of policy in those countries, the fact that these votes have passed lifted some of the reservations concerning M&A activity in the fourth quarter. The upcoming elections in France, the Netherlands and Germany are not expected to significantly affect German transaction activity.

In the past year, sellers often were industrial companies divesting individual divisions and private equity sponsors taking advantage of high prices. Distressed and forced sales continued to be rare. Strategic buyers leveraged the availability of cash and cheap financing to achieve growth through acquisitions, winning auctions for a number of high-profile transactions, such as the acquisition of the coffee machine and cookware producer WMF by French Groupe SEB for close to €1.6 billion. Higher valuations made it more difficult for private equity sponsors to achieve the yields they require, resulting in fewer buyouts and smaller deals overall with private equity sponsors as buyers. Apart from a few exceptions, individual domestic M&A transactions were generally valued below €1 billion in 2016. Outbound transactions included a number of significant deals by German corporates in the United States, such as the acquisition by Bayer AG of Monsanto Co. for approximately $66 billion and the acquisition by Lanxess AG of Chemtura Corp. for approximately $2.7 billion. Another significant cross-border deal was the December 2016 announcement that U.S.-based Praxair would purchase Germany’s Linde for $35 billion.

The number of public transactions in Germany was relatively flat compared to prior years and did not reflect the rise in stock prices and economic growth. In our view, this is at least in part a function of German corporate governance requirements and of the need to address complex rules applicable to public companies or to corporations in general. German public companies increasingly find themselves in situations in which they must defend against shareholder activism, including funds acquiring positions in the company and organized opposition from existing shareholders, or address unsolicited or competing bids. While such activity has been (and is likely to continue to be) less aggressive in Germany than in the U.S., investors are taking an increasingly active role, asserting pressure on previously entrenched management and supervisory boards by demanding transactions, reorganizations or other actions to unlock value for shareholders.

A number of other factors are influencing the M&A environment in Germany. Merger control issues are on the rise as a result of an increase in strategic M&A, leading to more frequent dispositions of assets. As a consequence, “hell or high water” provisions and reverse-termination fees have become more important. Additionally, Chinese investors, which account for a higher level of activity than previously, now tend to focus on high-profile and technology-leading companies and are prepared (and able) to pay high prices for these businesses — often justified by the expectation that a German target will be able to successfully access the Chinese market. The level of investments by Chinese buyers in the year ahead will depend on the economy and regulatory changes in China itself (see “Regional Focus: Asia”), as well as currency stability, the recognition of China as a market economy under the World Trade Organization, and the general political climate between China and the United States. Regardless, the success of Chinese buyers thus far has prompted political concerns and initiatives to tighten foreign investment controls on a European level. Reviews under the applicable German foreign investment control regimes have already intensified, making the identity of buyers and the presentation of their background increasingly relevant in bid evaluations.

Looking ahead, we expect corporations to increase the number and overall scope of acquisitions. Share buybacks and extraordinary dividends are often no longer regarded as desirable instruments, and corporates feel pressure to expand their businesses. Transformational M&A will play an important role. In addition, distressed M&A should rise as lenders are less likely, for regulatory and other reasons, to retain outstanding defaulted loans or other indebtedness with limited likelihood of repayment.

Brexit: German Perspective

The impact of Brexit on the German business climate has generally been rather limited. Parties (both German and international) considering investments in Germany do not appear to have placed critical weight on the U.K.'s exit from the European Union. However, investments by German corporates in the U.K. have been affected by the prospect of Brexit as German corporates have postponed a number of transactions there until more clarity on the terms of Brexit becomes available. Companies should take advantage of the common market rules before Brexit becomes effective, including by amending supply channels in order to avoid possible tariffs, making use of the free movement of labor and capital within the EU, and obtaining, where necessary, additional licenses to secure the continuation of operations, among other issues.

While some commentators posit that Frankfurt may benefit over time as a financial center in continental Europe, it is too early to tell whether that will be the case. Ultimately, if Brexit results in an increase of strategic investments in the EU (especially from non-EU buyers), Germany's share of activity may increase over time because of its actual or perceived relative economic and political stability when compared to other EU member states. The real risk of Brexit in the longer term is the general political impact it may have on the fabric of the EU as a whole. As the ongoing refugee and financial crises in certain countries continue to depress pro-EU sentiments, the underlying question is whether the populist movements across Europe will continue to see voter support and whether initiatives in other countries (*e.g.*, Austria, France, Italy, Netherlands) to leave the eurozone or the EU will gain momentum.

EUROPEAN CAPITAL MARKETS

Capital markets in Europe were mixed in 2016. The year saw a healthy volume of high-yield issuances in Europe after a very quiet start of the year. In the U.K., the Brexit vote impacted high-yield issuances somewhat, but such issuances continue. Initial public offering (IPO) volumes were down compared to previous years, but the IPO market this year should be open for strong candidates. Political developments (the Brexit vote, the Italian referendum rejecting reform proposals and the U.S. election) created periods when the capital markets were not generally available for new issuances. However, these "closed periods" were relatively short, and it is unclear how much these developments affected capital market activity overall. European capital markets have dealt with political volatility — notably the Greek debt crisis — for years, and investors seem to have become accustomed to such challenges.

The first part of the year has seen strong volumes of high-yield issuances in Europe. Looking ahead, if attractive interest rates on loans continue to be available, some existing high-yield issuers may look to refinance bonds with lower-cost loans, which would limit the number of "debut" high-yield issuers. The outlook for the IPO market remains uncertain, but the recent increases in key U.S. stock market indices give reasons for optimism. Rising interest rates in the U.S. may prompt U.S. issuers to seek euro-denominated debt if such rates are lower in Europe. In addition, any changes to the sanctions currently in place with respect to Russia could increase capital market activity coming from that region.

DACH: Volatility and HETA Restructuring

The capital markets in the DACH region (Germany, Austria and Switzerland) continue to be characterized by market volatility, mainly because of the European refugee crisis and the continuing financial crisis in countries such as Greece and Italy, as well as Brexit and its implications.

Most equity transactions in Germany last year (in terms of volume) originated from corporate realignment activity and a few large spin-offs, in part because of increasing pressure on German corporate boards to create shareholder value and deliver returns to shareholders.

In an environment where investors are risk-averse and seek to preserve exit options, the current stock markets favor larger, more liquid stocks. The climate for IPO candidates whose valuation was below €1 billion was difficult in 2016, a trend likely to continue in 2017. This was particularly true for companies in the technology, biotechnology or other growth sectors because of their risk profile, lack of liquidity and (related) valuation discounts. Most IPOs/private equity exits were structured as dual-track processes, and in light of the difficulties for smaller IPO candidates, most ended up as a trade sale or were abandoned.

In light of the ongoing market volatility, companies that intend to go public or raise capital on the equity markets increasingly are seeking to reduce their time to market by substantially completing due diligence and documentation processes in advance through "in the drawer" prospectus documents. As a result, thorough and well-crafted information for future investors is available early in the process, facilitating investor education, premarketing efforts and possible preplacements, which have lowered risk for equity transactions in the region.

In the DACH debt markets, the €11 billion tender and exchange offer of existing debt instruments of Austrian bank HETA by the province of Carinthia (represented by Skadden) was a landmark transaction likely to redefine the handling of future distressed debt restructurings of subsovereign obligations in Europe. The transaction involved a number of firsts in Europe, including the first successful distressed debt offer and restructuring under the EU Bank Recovery and Resolution Directive (BRRD), and constitutes an important precedent in Europe with regard to new ground rules on subsovereign distressed debt negotiations imposed by European member states as a result of the implementation of the BRRD.

The German debt markets were characterized by a high volume and significant number of corporate (investment grade) debt issuances in 2016. We expect this method of raising significant liquidity to continue this year, as the European Central Bank announced it would keep interest rates at historically low levels in the EU region. On the other hand, we saw fewer high-yield debt issuances in 2016 than in previous years due to the access by noninvestment-grade issuers to less expensive bank financings (increasingly with local financial institutions more intimately familiar with an issuer's business model, financial situation and prospects).