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PRIVATE MERGERS AND ACQUISITIONS

Private mergers and acquisitions in Germany: market analysis overview

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MARKET OVERVIEW

1. What are the current major trends in the private M&A market?

Like in 2015, the German economy has been strong in 2016, growing by 1.9%. Germany has been at the forefront of European M&A activity in 2016. M&A activity in Germany rose by 27% in value year-on-year. In its trend report for 2016, Mergermarket recorded 866 inbound and domestic transactions worth EUR72.2 billion, representing the highest value per year since 2007.

US-based investors remained the largest group of buyers in Germany in 2016. However, China made the headlines by investing 32 times more in German companies than in 2015. The "Made in China 2025" initiative implemented by the Chinese Government has fuelled China's interest in the well-regarded German markets for industrial technology, as part of its goal to strengthen its own manufacturing industry by making use of advanced technologies.

As in 2015, Germany's M&A activity continued to be driven by the industrial and chemicals sector, which contributed about EUR25.1 billion to the overall deal volume. The financial services sector stood out mainly because of the EUR17 billion takeover of Westdeutsche Genossenschafts-Zentralbank by DZ Bank AG, by far the largest private domestic deal of 2016 by deal value.

Following a degree of softening in the third quarter, German private equity activity finally reached a post-crisis high in 2016, with buyout activity ending up with the highest value since 2007 and a recorded 153 deals valued at EUR16.6 billion. Primary buyouts accounted for the largest deals, namely:

- IVG Immobilien AG sold Officefirst Immobilien AG to the Blackstone Group for EUR3.3 billion.
- The Carlyle Group acquired Atotech from Total SA for EUR2.9 billion.

Overall, the buyout value was only slightly behind exit value in 2016, accounting for a deal value of EUR16.6 billion compared to EUR18 billion. However, disregarding the two large transactions mentioned above, the buyout volume was significantly lower. It is remarkable and a sign of the high prices realisable in the market that less than half of all exits were secondary buyouts, making up only EUR4.4 billion of the total deal value.

In 2016, the market continued to be favourable to sellers, allowing them to convert demand into high prices. In the authors' view, this can be attributed to a general shortage of suitable targets and the availability of significant capital to potential buyers.

2. What has been the level of private M&A activity in the previous year?

In 2016, most of the inbound and domestic transactions, as well as the majority of the EUR72.2 billion deal value, can be attributed to private M&A. The number of inbound and domestic public transactions did not reflect the rise in stock prices and economic growth. However, 2016 should be considered as an extraordinary year for German outbound public M&A, especially as the biggest ever acquisition by a German company, the purchase of Monsanto Company by Bayer AG for EUR56.454 billion in cash, accounts for a significant portion of the total outbound deal value of EUR127.2 billion.

DEAL STRUCTURES

3. What are the current trends in the structuring of private M&A transactions?

In 2016, a continuing seller-friendly environment, with high price expectations of sellers across all industries, led to a significant number of transactions being conducted as structured auctions. These aimed to fetch high prices and to target a broad range of investors.

Based on market observations and the authors' experience, most transactions were cash deals with a locked-box mechanism. The use of traditional price adjustment mechanisms appears to be in decline. Earn-out provisions and other conditional purchase price elements are still rare, although the number of earn-out provisions is growing slowly but steadily.

4. What are the current trends in the terms and documentation of private M&A transactions?

De minimis provisions and thresholds (sometimes in the form of deductibles) are now market standard in Germany and can be found in the vast majority of purchase agreements. In addition, the trend of decreasing indemnification caps continues, with sellers often entering negotiations with a low digit percentage range of the purchase price.

Material adverse change (MAC) provisions, in various forms, are still sometimes agreed on in German transactions. MAC provisions can no longer be considered market standard in Germany despite their popularity in other jurisdictions, particularly in the US. However, closing conditions referring to the absence of non-material breaches have become rather frequent, with details of these provisions being extensively negotiated.

Warranty and indemnity insurance (W&I) is more and more accepted. In auction processes, the availability of W&I is used as an argument to reduce caps (including by providing stapled insurance options to auction draft purchase agreements). Exclusions from insurance coverage are often broader than those agreed in purchase agreements. Pricing for W&I has decreased over the years and its range of applicability has been extended. In individual instances, insurers have even agreed to insure specified known risks.

5. What are the current trends in how private M&A transactions are conducted?

The seller-friendly environment of 2016 has led to a confirmed use of structured auctions. This has also influenced the way in which due diligence processes are conducted. Potential buyers are often provided with a vendor due diligence report only in the initial stages of the auction, and access to a data room is delayed to the second and third stages of the process. This staggered approach is often combined with higher than usual time constraints on the buyside.

CROSS-BORDER LITIGATION AND ARBITRATION

6. Is it common market practice for a share purchase agreement to provide for a foreign governing law and/or jurisdiction? If so, in what circumstances does this occur and which governing law and/or jurisdiction are common choices?

Transaction documents are generally governed by the laws of the jurisdiction in which the principal target company is located. Deals on German targets are therefore usually subject to German law.

Disputes are usually submitted to arbitration (and more rarely litigation) in the jurisdiction of the governing law of the agreement, although neutral arbitration venues have become more popular.

7. Is it market practice for an arbitration provision to be included in private M&A documents? Are arbitration clauses enforceable in your jurisdiction? Do local courts respect the choice of jurisdiction in an arbitration clause?

Specific arbitration provisions have become more frequent when parties have agreed to include a form of material adverse change (MAC) provision in the purchase agreement. Fast-track arbitration aiming to determine whether a MAC actually occurred seems to have caught the attention of many parties.

Arbitration provisions are generally enforceable in Germany if they meet the requirements laid out in German statutory law. The local courts must generally respect arbitration provisions, even if they refer to a jurisdiction outside Germany. However, arbitration clauses may be considered ineffective if they are grossly prejudicial to one party. Additionally, before a party can bring foreclosure proceedings in Germany based on an arbitral award, the award must be declared enforceable by a German court.

RECENT DEVELOPMENTS AND PROPOSALS FOR REFORM

8. Have there been any significant recent or proposed legal developments affecting the market that could impact on transactions?

Transactions in the internet and technology industries may prove problematic in 2017 and going forward, based on new merger control limitations. This is because entities in these industries can have low revenues but benefit from high valuations due to their access to large data volumes. Current regulations provide for intervention thresholds based on company revenues only, and disregard the data-based business models of start-ups, which in many cases have "anemic" revenue. Therefore the authorities, such as the German Monopolies Commission, have proposed to redefine thresholds in Europe and Germany to better reflect these realities. In addition, the Federal Cartel Office has demanded more effective decision criteria to counter monopolisation tendencies in the internet economy.

In the aftermath of the attempted acquisition of Aixtron SE by Fujan Grand Chip Investment Fund LP, the German Government is pushing for EU regulations that would allow member states to protect companies active in strategic sectors from approaches by foreign (often Chinese) investors, in particular when these investors are supported by governments.

9. What will be the main factors affecting the market next year, and how do you expect the market to develop?

The overall positive outlook of 2017 may be adversely affected by political pressures in the EU and heightened concern about the banking system. However, Germany's asset base (especially in the industrial, chemicals and automotive sectors) should remain attractive to foreign buyers, as high levels of capital remain available in particular to US and Chinese buyers. The domestic M&A volume may be spurred by German corporates taking on the "industry 4.0 challenge", a concept aiming to unite technology and manufacturing industries.

The Federal Cartel Office and the German Monopolies Commission made headlines in 2015 by opposing the sale of Kaiser's Tengelmann to Edeka, two German supermarket chains. German merger control authorities as well as the European Commission have maintained a high level of scrutiny throughout 2016 and will likely continue to do so in 2017. As a consequence, a number of divestitures were implemented to address anti-trust concerns and secure regulatory clearances. These deals tend to show an increased degree of complexity and may be prepared in advance of the signing of a transaction or conducted as a consequence of specific demands from, or commitments agreed with, merger control authorities. Some deals, such as most recently the agreed merger between the London Stock Exchange and Deutsche Börse AG, may eventually be prohibited, if divestitures would significantly impact the overall value of the transaction and are therefore rejected by the parties.

Foreign investment control is strengthened in practice, even based on current laws, and more deals targeting sensitive assets (for example, relating to defence and encryption) may be prohibited following regulatory scrutiny. In October 2016, the Federal Ministry for Economic Affairs and Energy initially turned down the request of IDG Capital Partners, a China-based venture capital firm, to clear the acquisition of Ledvance GmbH, the general lighting lamps division of Osram GmbH. The transaction was only cleared after detailed examination.

Further, the US Committee on Foreign Investment (CFIUS) has already proven to effect European transactions. In October 2016, the Federal Ministry for Economic Affairs and Energy withdrew its support for the initially supported takeover of chip equipment maker Aixtron by Grand Chip. Shortly after, CFIUS blocked the deal on US national security grounds.

Practical Law **Contributor profiles**

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Recent transactions

- LetterOne Holdings SA, a group of Russian investors led by Mikhail Fridman, in its:
- US$1.6 billion acquisition of E.ON E&P Norge AS from E.ON Beteiligungen GmbH; and
- US$725 million sale of DEA UK Holdings Limited to Ineos AG.
- Gilead Sciences Inc., a research-based biopharmaceutical company, in its acquisition of the Farnesoid X Receptor programme for the treatment of liver diseases from Phenex Pharmaceuticals AG.
- Ball Corporation, a metal and plastic packaging producer for the food, beverage, aerospace and defence industries, in its proposed US$8.4 billion acquisition of Rexam PLC.
- Coty Inc., a manufacturer of beauty products, in its merger with the fine fragrance, colour cosmetics and hair colour businesses of The Procter & Gamble Company in a tax-free Reverse Morris Trust transaction.
- Archer Daniels Midland Company, a producer of food ingredients, renewable fuels and naturally derived alternatives to industrial chemicals, in its acquisition of Wild Flavors in an all-cash transaction valued at EUR2.3 billion enterprise value

Languages. German, English

Publications

- *"M&A in Germany: Lexology Navigator Q&A," Lexology, April 2016.*
- *"The Newfound Attractiveness of European M&A," Skadden, Arps, Slate, Meagher & Flom LLP, January 2015.*
- *"Activist Investing in Europe: A Special Report," Skadden, Arps, Slate, Meagher & Flom LLP, October 2014.*
- Co-author: *"Münchener Handbuch des Gesellschaftsrechts," Volume 2 (4th Edition), 2014; "German Bundestag Approves Law Regulating High Frequency Trading," Skadden, Arps, Slate, Meagher & Flom LLP, 7 March 2013; "EC Proposes That European Central Bank Become Prudential Supervisor of Eurozone Banks," Skadden, Arps, Slate, Meagher & Flom LLP, 20 September 2012.*
- "Measures to Strengthen the European Banking System," *Skadden, Arps, Slate, Meagher & Flom LLP*, 31 October 2011.

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Non-professional qualifications. Second State Exam, Hanseatic Higher Regional Court of Hamburg, 2016; First State Exam, University of Trier, 2012

Recent transactions

- Air Products and Chemicals, Inc. in its US$3.8 billion sale of the performance materials division of its materials technologies segment to Evonik Industries AG.
- Sealed Air Corporation in the proposed tax-free spin-off of its Diversey Care division and the food hygiene and cleaning business within its Food Care division into a new company called New Diversey.
- DENTSPLY International Inc. in its private placement of senior notes, and in a concurrent cash tender offer to purchase an amount of its outstanding senior notes.

Languages. German, English