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MERGERMARKET

CROSS BORDER M&A INDEX

Q2 2016

CONTENTS

CROSS-BORDER M&A INDEX Q2 2016

1

Hesitancy persisted as global markets remained volatile: China's slowdown showed no signs of abating; oil prices were still down despite recovering some ground; and political uncertainty grew globally. The UK held its EU referendum, presidential nomination campaigns occurred in the US, and a number of other parliamentary elections were held worldwide.

As a consequence, Baker & McKenzie's Cross-Border M&A Index, which tracks quarterly deal activity using a baseline score of 100, dropped to 176 — down 33% from Q2 2015's total of 263, the lowest Index result since Q3 2013.

THE GLOBAL PICTURE

2

Cross-border M&A made up 31% of all deal value and 35% of all deal volume in Q2 2016, compared to 37% and 30% for the same period in 2015.

Uncertainty in the lead up to the EU referendum hit UK M&A in particular, with Q2 2016 outbound deal values down 82% and inbound deal values down by 89% on Q2 2015.

SECTOR FOCUS: MINING

3

Cross-border M&A in the mining sector held steady for the first half of 2016, with US\$8.1bn from 38 deals.

REGIONAL FOCUS: MIDDLE EAST

4

UAE and Saudi Arabia lead the way in 2016 M&A.

SPOTLIGHT: MERGER CONTROL

5

The number of countries and regions with merger control regimes now exceeds 120. This may have a direct effect on both the viability of an M&A transaction and the manner in which it is carried out. Early awareness of national merger control rules and a robust and principled evaluation of the risks of failing to notify are vital.

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Cross-border M&A volume and values were both subdued in Q2 2016, as investors held their breath.

Headwinds that began to slow the progress of cross-border M&A in Q1 2016 continued to strengthen. Hesitancy persisted as global markets remained volatile: China's slowdown showed no signs of abating; oil prices were still down despite recovering some ground; and political uncertainty grew globally. The UK held its EU referendum, presidential nomination campaigns occurred in the US, and a number of other parliamentary elections were held worldwide.

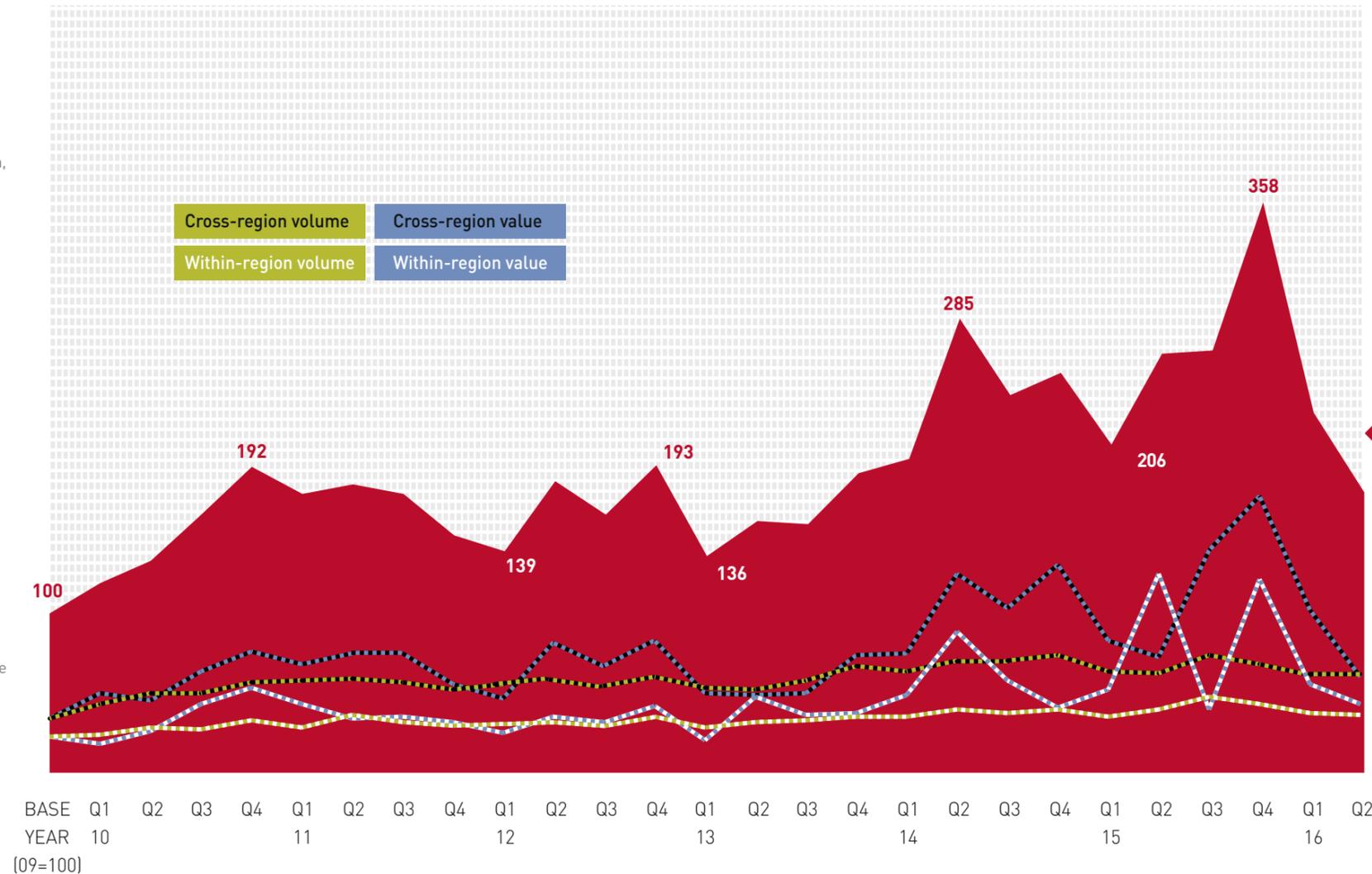
As a consequence, Baker & McKenzie's Cross-Border M&A Index, which tracks quarterly deal activity using a baseline score of 100, dropped to 176, down 33% from Q2 2015's total of 263, the lowest Index result since Q3 2013. Buyers announced 1,320 cross-border deals worth US\$214bn, a 4% drop in volume and a 45% drop in value compared to Q2 2015. The EU (particularly the UK) and North America experienced the largest reductions in deal values.

The drop can be attributed, at least in part, to fewer megadeals – those above US\$5bn in value – in the first half of the year. While there were 21 megadeals struck in the first half of 2015 with a total value of US\$296bn, the 18 thus far in 2016 are worth 23% less at US\$228bn. Only three of those occurred in Q2 2016 (worth US\$29bn).

North America was the largest cross-regional outbound market by volume, with 263 outbound deals worth US\$38.5bn – 67% of those targeted the EU. Asia Pacific, while not as acquisitive with 188 deals, spent US\$50.5bn on cross-regional deals. Its main target was also the EU, spending US\$29bn across 96 deals.

On the sector side, industrials (199 deals), technology (182 deals) and business services (172 deals) topped the volume charts, followed close behind by consumer (160 deals). Pharma produced the highest-value Q2 deal: German pharma specialists Boehringer Ingelheim acquired French veterinary pharma company Merial, in a swap of assets transaction worth US\$12.56bn.

We expect cross-border activity to remain slower, but steady, as risk factors continue to influence investment decisions.



Cross-Border
M&A Index
Q2 2016
176

Methodology: Baker & McKenzie's Cross-Border M&A Index assesses the strength of worldwide cross-border M&A activity in each quarter since Q1 2010. Based on a weighted average of cross-border deal values and volumes in each quarter, we calculate a score from a baseline figure of 100, which represents the level of activity in 2009. That score provides one easy-to-understand indicator of how cross-border deal activity changes from quarter to quarter, enabling viewers to identify patterns.

We define cross-border dealmaking as any M&A activity involving a bidder and target based in separate countries. The overall index score is comprised of four weighted sub-categories, giving slightly more weight to more ambitious deals between parties in two different regions.

Data correct as of 1 July 2016

Q2 2016 TOTAL
CROSS-BORDER DEALS

1,320 deals

VOLUME

4%
ON Q2 2015

Q2 2016 TOTAL
CROSS-BORDER DEALS

\$214bn

VALUE (US\$)

45%
ON Q2 2015

CROSS-REGION

798 deals

VOLUME

1%
ON Q2 2015

CROSS-REGION

\$136.9bn

VALUE (US\$)

17%
ON Q2 2015

WITHIN-REGION

522 deals

VOLUME

8%
ON Q2 2015

WITHIN-REGION

\$77.1bn

VALUE (US\$)

66%
ON Q2 2015

Q2 2016 MOST ACTIVE SECTORS
(CROSS-BORDER DEALS)

BY VOLUME

INDUSTRIALS

199 deals

(WORTH US\$28.1bn)

BY VALUE

TECHNOLOGY

US\$38bn

(182 DEALS)

2 THE GLOBAL PICTURE

HEADLINES

- 1 Cross-border M&A made up 31% of all deal value and 35% of all deal volume in Q2 2016, compared to 37% and 30% for the same period in 2015
- 2 Uncertainty in the lead up to the EU referendum hit UK M&A, with Q2 2016 outbound deal values down 82% and inbound deal values down by 89% on Q2 2015
- 3 Chinese bidders continued to drive values in Q2 2016, with 97 outbound deals worth US\$40.7bn – 23% and 132% higher than the same period in 2015

On the global M&A stage, all eyes were on the UK's EU referendum. Cross-border M&A volumes involving the UK remained relatively steady throughout the second quarter of 2016, with 128 outbound deals and 144 inbound (compared with 149 and 126 respectively in the same quarter of 2015).

But values were a different story: Q2 2016 outbound deals were worth only US\$12.1bn, down 82% on Q2 2015, while inbound deal values fell by 89% from US\$118.3bn to just US\$12.9bn.

Cross-border dealmaking hesitancy was also felt in the US. While it remained the most active outbound M&A market in Q2 2016 by volume, with 261 outbound deals worth US\$31.2bn, volume and values were down 19% and 40% respectively, compared with the same period in 2015. Only FMC Technologies' all share merger of equals with Technip in France, worth US\$4.6bn, made the list of top ten deals for the period.

Inbound US M&A activity remained consistent with 214 deals, compared with 204 deals in the same period in 2015, but values took a hit – down 47% on Q2 2015, at US\$46.9bn. Nonetheless, five of those inbound deals were in the top ten for Q2 2016, worth a total of US\$18.1bn.

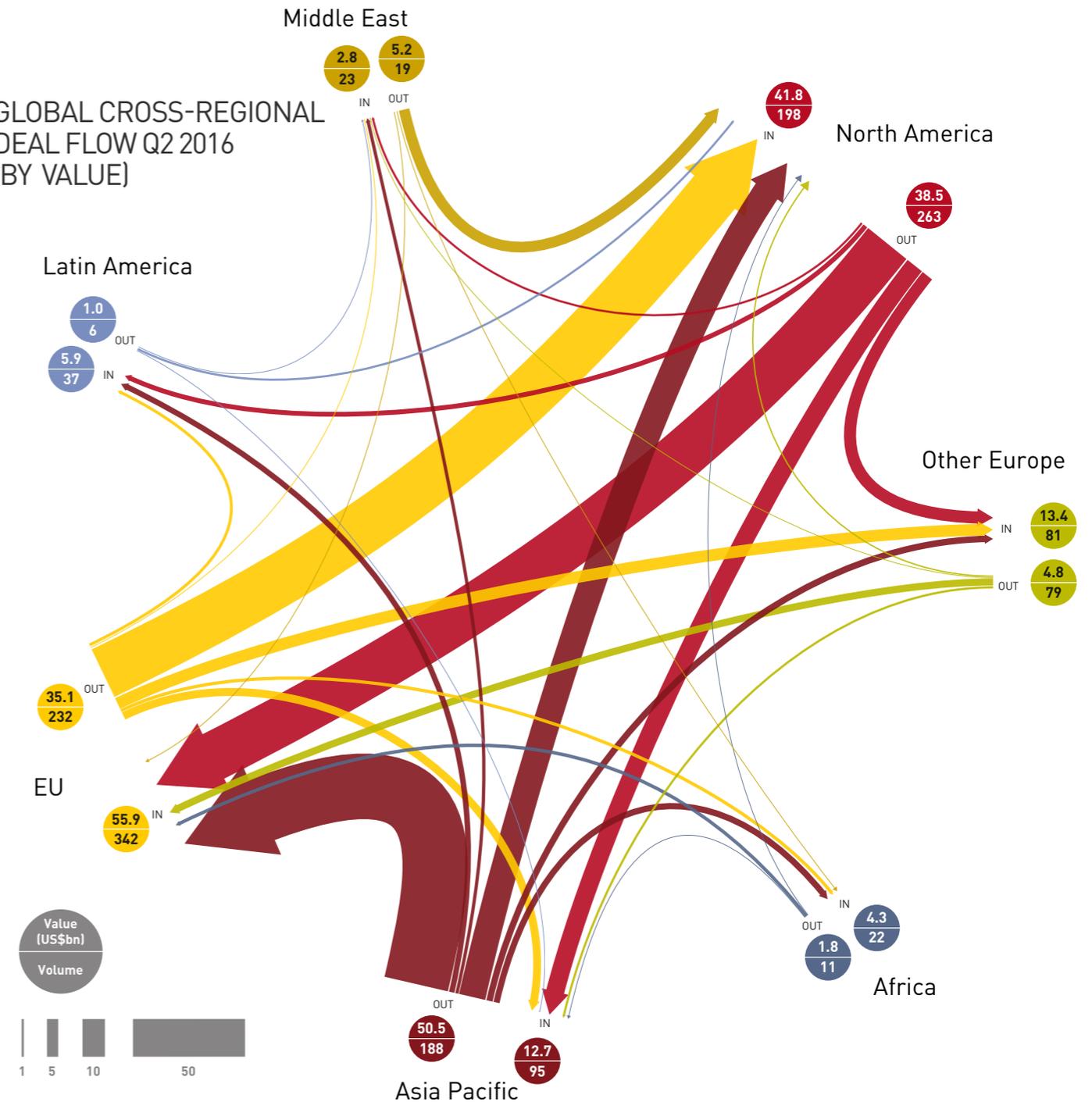
Great haul of China

In a continuation of a trend identified in the Q1 2016 Baker & McKenzie Index, Chinese bidders drove values, providing the key highlight in global cross-border M&A in Q2 2016. China's 97 outbound deals in Q2 were worth US\$40.7bn – 23% and 132% higher than the same period in 2015. The focus was on investments in technology (15 deals worth US\$17.0bn) and industrials (17 deals worth US\$4.8bn) – part of the country's ongoing efforts to move up the value chain. China also demonstrated a renewed interest in mining (four deals worth US\$4.4bn).

Chinese buyers shifted their attention to the EU for targets, with 43 deals (compared with 23 in wider Asia Pacific and 19 in North America).

The largest of these included Chinese industrial products and services company Midea Group's takeover offer for German-listed KUKA, an industrial automation company worth US\$4.3bn, as well as private equity firms JAC Capital Management and Wise Road Capital Management's acquisition of Dutch-based NXP Semiconductors' Standard Products unit for US\$2.8bn.

GLOBAL CROSS-REGIONAL DEAL FLOW Q2 2016 (BY VALUE)



HEADLINES

1 Cross-border M&A in the mining sector held steady for the first half of 2016, with US\$8.1bn from 38 deals

2 China has been the big spender during the past 18 months, with 22 cross-border mining deals worth US\$8.7bn

3 Asia Pacific attracted US\$5.9bn worth of the activity over the past 18 months, followed by North America (US\$5.4bn) and Africa (US\$4.3bn)

Cross-border M&A in the mining sector remained stable for the first half of 2016 with 38 deals worth US\$8.1bn, despite concerns about China's economic slowdown and weak commodity prices. Volume was down slightly on H1 2015, during which there were 40 deals worth US\$7.1bn, but values have shown improvement, and the sector remains on track for another solid year.

"The market may have hit bottom earlier this year," says Richard Blunt, Partner in Baker & McKenzie's Corporate department in London and a member of the Energy, Mining and Infrastructure industry team. "Not for everybody, but the recent rallies in Glencore and Anglo American stocks suggest a possible turnaround. It's not going to be quick but we're seeing optimism among corporates, some of whom have already rebuilt their balance sheets.

"Nevertheless, distressed asset sales and disposal programmes are high on the agenda for the time being," he adds. "Consolidation may happen, but not necessarily this year."

While Canada has been the most active acquirer over the past 18 months, with 25 deals worth US\$1.3bn, China has been the big spender, with 22 deals worth US\$8.7bn. Leading the way was China Molybdenum: in April 2016, it agreed to acquire the niobium and phosphates businesses of Anglo American in Brazil, in a deal worth US\$1.5bn. This was followed, in May 2016, by the US\$2.65bn purchase of a 56% indirect stake in Congo-based copper-cobalt mining company Tenke Fungurume Mining.

Australian and Canadian-based companies were the most common targets for mining transactions, with 18 and 16 deals apiece worth US\$1.7bn and US\$2.8bn respectively, while US targets attracted 15 deals worth US\$2.6bn.

Financial investors enter the fray

The fact that the mining market may have hit bottom (or is perceived to have little further to fall) is attracting investors from across the spectrum – and suggests that now may be an opportune moment to make a move, says Blunt.

Increasingly, financial investors expressing interest include private equity, often working in tandem with sovereign wealth funds and hedge funds, searching for new opportunities.

"These investors want to generate value, with a clear route to exit," says Blunt. "Some are saying H2 2016 is going to be quite busy for mining deals and they're concerned they'll face more competition if they wait – at the moment, it's relatively limited."

In the past, most financial investors preferred to avoid commodity risk, but the landscape is changing: "Specialist mining funds have appeared in Canada and Australia, and we've seen increased interest from the UK and other jurisdictions. In Australia, EMR Capital was one of the newest funds to deploy capital in the past 12 months and it made a number of acquisitions, mainly in copper. Funds are exploring value opportunities," says John Mollard, Global Head of Mining at Baker & McKenzie in Melbourne.

Technology drives new deals

Another driver for improved optimism is the uptick in deals around minerals essential to consumer-driven technology, like lithium.

"Some major players are going to put additional development funding into their lithium deposits," says Mollard. "For example, as part of a 2015 deal with Australia's Reed Industrial Minerals, Jiangxi Ganfeng Lithium signed a memorandum of understanding to buy 100% of the 6% Li2O from the spodumene [a lithium source] produced from its Mount Marion lithium project."

Other minerals associated with new technology for batteries and electricity storage – such as graphite – have been attracting mining M&A activity for some time and this trend looks set to continue.

"We are seeing a fair bit of interest in mineral sands, which include specialist minerals used for high tech applications including the aerospace industry," says Mollard. "There is interest and ongoing exploration around these, especially in Africa."

Asia Pacific digs deep

While China's slowdown may have affected cross-border mining M&A, it remains a major player, says Mollard: "Its interest in mining has revived over the past six months and not just where it has invested before – now it includes these high-tech minerals and base metals."

With China driving activity, Asia Pacific generally is a key engine of the cross-border M&A market. Over the past 18 months, a total of 55 cross-border mining deals worth US\$14.5bn were carried out by Asia Pacific-based bidders. This represents almost 70% of the value of deals in the sector. Much of the activity has been intra-regional (30 deals worth US\$5.7bn), as well as sizable targeting

assets in Africa, North America and Brazil.

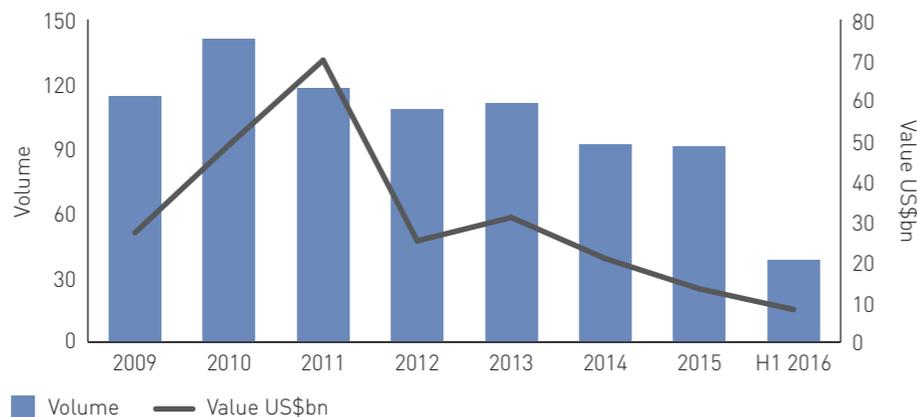
"We're not surprised that Asia Pacific is still a major engine of growth," adds Blunt. "China's growth rate alone dwarfs more or less anywhere else in the world."

Mollard continues, "Japan still looks like an interested player and Thailand has been active in certain sectors, especially energy. It's a huge region, and with high demand for raw materials."

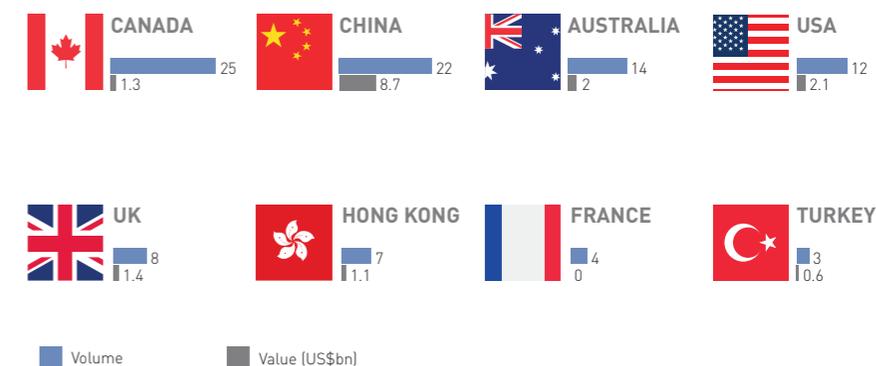
Watch the CEO

According to Blunt, one of the signs as to where the market is heading is who's running the businesses: "When you're around the peak, it tends to be geologists," he says. "At the bottom of a downcycle, people with financial backgrounds tend to be brought in."

MINING CROSS-BORDER M&A 2009 - 2016



MOST ACQUISITIVE COUNTRIES WITHIN MINING 2015-2016



4 REGIONAL FOCUS: MIDDLE EAST

HEADLINES

- 1 Cross-border deals targeting the Middle East reached US\$7.7bn in 2015 – its highest value since 2012 – based on 40 deals
- 2 This remained steady in H1 2016, hitting US\$5.6bn from 20 deals – up from 15 deals worth US\$3.7bn in H1 2015
- 3 Outbound deals set a new record in 2015, with US\$32.9bn on the back of 83 deals – the highest value of any year covered by the Baker & McKenzie M&A Index (which goes back to 2009)
- 4 Asia Pacific and North America were the most active cross-regional buyers of Middle East targets by volume in 2015-16, with a total of 29 deals between them

Volatile oil prices, geopolitical uncertainty and a shifting M&A landscape have not constrained dealmaking in the Middle East. Following a record-breaking 2015, cross-border M&A in the region remained solid through the first half of 2016, with strong deals in the pipeline.

“It’s been a relatively robust year thus far, off the back of a very busy 2015,” says Will Seivewright, Corporate Partner with Baker & McKenzie Habib Al Mulla in Dubai. “The underlying economic fundamentals, such as anticipated GDP growth in the UAE and Saudi Arabia, continue to draw investors.”

Hot spots

The UAE and Saudi Arabia attracted the most interest over the past 18 months, with 40 deals between them – 12 coming from the US and 10

of those going to the UAE. China’s three cross-regional deals (two in the UAE and one in Jordan) generated the highest value, at US\$1.4bn.

It’s a similar story on the outbound side as markets look to diversify their portfolio beyond oil, with the UAE driving activity with 58 deals during 2015-16, followed by Qatar (21 deals), and Saudi Arabia (16 deals). One of the highest value outbound deals in the region reflects this trend: the Public Investment Fund, controlled by the Saudi Arabia government, acquired a 5.6% stake in Uber Technologies, the US-based online car booking service, for US\$3.5bn.

The oil question

Substantial oil-based cash reserves have maintained healthy cross-border M&A activity in the Middle East for over a decade. This has

allowed countries in the region, particularly those of the Gulf Cooperation Council, to become key strategic investors around the world. But oil is a finite resource and, as alternate energy strategies take hold and oil prices remain depressed, these countries increasingly look to diversify their investments.

“Low oil prices have already affected M&A activities in some sectors in the GCC region,” says Zahi Younes, Corporate & Securities Partner at Baker & McKenzie’s associated firm in Riyadh. “For example, the Saudi government cut spending, which had a negative impact on sectors like construction, infrastructure, and oil and gas, and by extension on M&A activity.”

However, Younes also feels that the price drop may have a positive impact in the long run: “We’re already seeing more strategic and focused outbound investment. I expect Saudi Arabia to take a path similar to the UAE and Qatar, following the launch of its ‘Vision 2030’ strategy in April 2016, designed to diversify its investment portfolio. This will change the M&A landscape and allow international investors to capitalize.”

Consumer-driven M&A

The young, affluent and growing populations of the Middle East are attracting M&A activity, particularly on the consumer side. For example, in the first half of 2016, two-thirds of inbound deals targeting the UAE were in consumer and TMT (telecoms, media and technology).

It’s a similar story in Saudi Arabia, where there is increased activity in pharma, healthcare and leisure – “anything that touches the consumer,” says Younes. In response, some are using M&A to shift from a distribution model – which relies on distributors and suppliers representing a business or a brand on the ground – to a direct presence model.

“This usually involves joint ventures with local partners and has been the trend in the retail sector and in the fashion industry in particular for a few years now, in an effort to stay competitive,” says Younes.

“We’re also seeing a greater flow of M&A from family businesses in Saudi Arabia,” he adds. “These deals are increasingly sophisticated, possibly because new generations are more open to foreign investors acquiring a stake in order to grow further and develop their businesses.”

Valuation is a challenge

While demographics and buy side demand are driving M&A activity, assets are limited, which is pushing up valuations. At the same time, buyers are scrutinizing those higher valuations more than ever – “and this can be the biggest impediment to getting deals across the line,” says Seivewright.

Handled badly, there is a risk of post-deal disappointment. Seivewright adds that international investors are already finding it difficult to build investment models in the region because of ongoing changes in subsidies, utility prices and exchange rates.

“This is all causing some hesitation,” he warns.

Buyer beware

For inbound investors, finding investment partners who understand the local landscape and regulatory regimes can make all the difference.

“There are complexities here around foreign ownership and beyond that do not exist elsewhere,” says Seivewright. “Understanding and managing the expectations of inbound investors is essential.”

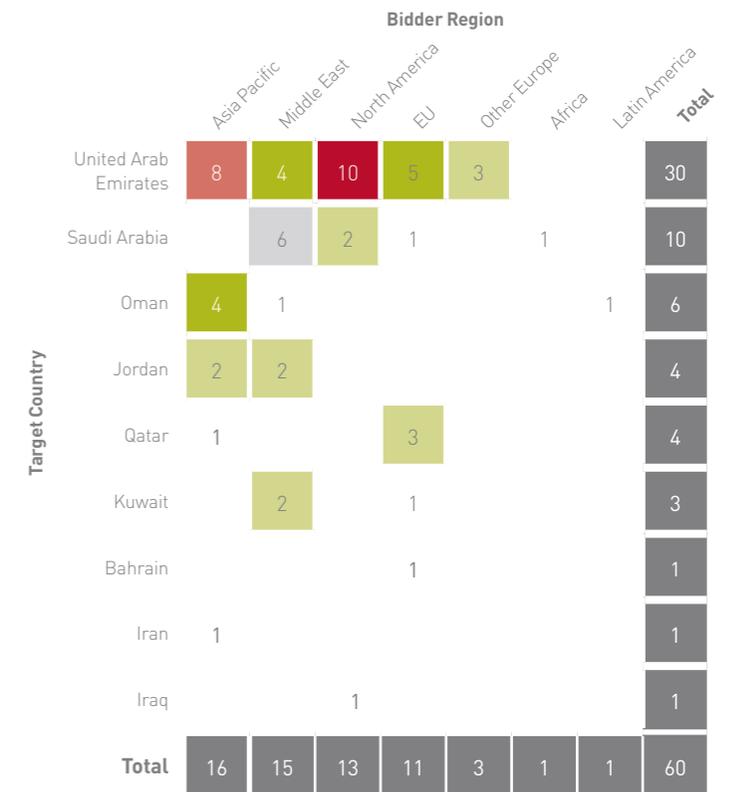
Exiting a joint venture in this region is not as easy as in Western jurisdictions so it pays to plan ahead: “Where possible, structure the deal in a way that allows a soft exit,” says Younes. Regulatory changes, such as those being implemented in Saudi Arabia, need to be taken into account when planning any new investments.

Future drivers

Overall, anticipated GDP growth in the Middle East through to 2020, coupled with regional demographics, point to a gradual growth story in cross-border M&A.

“There has been some slow down but I’m positive about the rest of the year – as well as next year,” says Younes.

2015 – 2016 CROSS-BORDER M&A WITH MIDDLE EAST TARGET (BY TARGET COUNTRY AND BIDDER REGION)



For the purposes of this report, the Middle East was defined as: Bahrain, Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, UAE

Volume



2015 – 2016 CROSS-BORDER M&A WITH MIDDLE EAST BIDDER (BY BIDDER COUNTRY AND TARGET REGION)

Bidder Country	Target Region							Total
	EU	Asia Pacific	Africa	Middle East	Other Europe	North America	Latin America	
United Arab Emirates	14	14	10	7	5	5	3	58
Qatar	9	2		1	6	3		21
Saudi Arabia	6	2	3	1	1	2	1	16
Bahrain	7			1	1	3		12
Kuwait	3		1	4	1			9
Lebanon	1		1	1				3
Oman	2							2
Jordan	1							1
Total	43	18	15	15	14	13	4	122

For the purposes of this report, the Middle East was defined as: Bahrain, Iran, Iraq, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, UAE

Volume



EYE ON THE FUTURE

Three key trends to watch

- Buying in tech and talent:**
 The Middle East is looking for investment that can transport know-how and new technology to the region, opening the door to further M&A. "For example, Abu Dhabi's investment and development company, Mubadala, entered into a joint venture with IBM in 2015 to bring cognitive software to the region," says Seivewright.
- Saudi Arabia in the long term:**
 Saudi Arabia's Vision 2030 promises long-term benefits. "One of the key elements is opening the Saudi market to foreign investment. Laws and regulations are being introduced that could improve M&A, but because everything is happening at the same time, some foreign investors may be waiting for the dust to settle," says Younes.
- Inbound private equity:**
 While international PE firms are interested in the region's growth story, they face some hurdles due to local laws and foreign ownership restrictions, and are at a competitive disadvantage compared to local corporates when it comes to bidding for assets. "Some international PE firms are partnering with local PE firms to overcome some of those challenges," says Seivewright. "The Blackstone Gems deal with Fajr Capital is a prime example. But there is no 'one size fits all' solution for these transactions."

5 SPOTLIGHT: MERGER CONTROL

Solving the global jigsaw

How do you manage the risks linked to local merger control laws?

The number of countries and regions with merger control regimes has continued to rise in recent years and now exceeds 120. This increasingly complex regulatory minefield may have a direct effect on both the viability of an M&A transaction and the manner in which it is carried out. Almost all merger regimes provide for penalties for failure to notify qualifying transactions and most are suspensory, meaning that the deal cannot close until regulatory clearance is obtained.

In 2015, antitrust reportedly frustrated transactions in excess of US\$50bn. Within the context of this environment and against a backdrop of record M&A activity levels in 2015, we are seeing transactions being managed more actively to mitigate these risks.

Addressing the risks

M&A deals that fall within one or more merger regimes are responding to these challenges in a variety of ways, including:

- the inclusion of a break fee, reverse break fee or indemnity in the acquisition agreement. Parties are increasingly allocating the financial risk that a transaction may not proceed as a result of antitrust concerns through the use of one of these deal protection mechanisms. Those providing financial comfort need to consider carefully the parameters of that commitment and any appropriate collars and caps that may be deployed;
- pre-closing divestitures or pre-emptive remedies to tackle antitrust concerns;
- making a "no names" enquiry of the local competition authority to exclude the need to notify where the law is unclear; and
- implementing best practice techniques to manage pressure before antitrust approval in order to integrate the target into the buyer's business, exchange competitively sensitive information or coordinate market conduct prior to closing ("gun-jumping"). Merger control rules generally require companies to remain independent until approval is granted.

Best practice includes:

- restricting confidential information to a limited number of people, retaining an independent third party to evaluate commercially sensitive data and establishing information barriers;
- ensuring any buyer protection from adverse changes in the value of the target's business in the pre-closing phase, contained in the acquisition documents, do not raise any gun-jumping concerns by including ordinary course of business decisions; and
- providing detailed gun-jumping guidance on what is permitted in the run up to completion so that as much planning can take place as possible without overstepping the mark.

Merger control authorities worldwide are increasingly baring their teeth when it comes to non-compliance with notification and standstill obligations. The trend is not confined to one region or type of authority or company. Early awareness of national merger control rules and a robust and principled evaluation of the risks of failing to notify are vital.



BAKER & MCKENZIE

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