



**Baker
McKenzie.**

CROSS-BORDER M&A INDEX

Q1 2017

CONTENTS

1

CROSS-BORDER M&A INDEX Q1 2017

While the political turbulence of 2016 has shown little sign of abating, dealmakers seem to have taken the volatility on board. The Index is down on the past quarter but megadeals have kept it from sinking further.

2

THE GLOBAL PICTURE

Cross-border M&A made up 49% of all deal value and 35% of all deal volume in Q1 2017. North American companies were in high demand by overseas bidders, while Japan continued its outbound M&A adventure.

3

SECTOR FOCUS: INDUSTRIALS

In 2016, there were 942 cross-border deals in the industrials sector, an increase of 23 on 2015 and a post-crisis record. Value also hit a post-crisis high of US\$116.8bn. However, companies can't afford to be complacent. We reveal the four key trends that will drive the industrials M&A market in 2017.

4

SPOTLIGHT: COMPLIANCE RISKS

In February 2017, the Fraud Section of the US Department of Justice (DOJ) published its *Evaluation of Corporate Compliance Programs* (Evaluation Guidance). With that in mind, we examine how to mitigate compliance risks.

About Mergermarket

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Q1 2017: IN NUMBERS

Q1 2017 TOTAL
CROSS-BORDER DEALS

1,238 deals
VOLUME

18%
ON Q1 2016



Q1 2017 TOTAL
CROSS-BORDER DEALS

\$331.2bn
VALUE (US\$)

3%
ON Q1 2016



Q1 2017 MOST ACTIVE SECTORS
(CROSS-BORDER DEALS)

BY VOLUME

TECHNOLOGY

182 deals

(WORTH US\$14.9bn)



BY VALUE

CONSUMER

US\$113.3bn

(142 DEALS)



CROSS-REGION

760 deals

VOLUME

15%
ON Q1 2016



WITHIN-REGION

478 deals

VOLUME

22%
ON Q1 2016



CROSS-REGION

\$239.3bn

VALUE (US\$)

1%
ON Q1 2016



WITHIN-REGION

\$91.9bn

VALUE (US\$)

9%
ON Q1 2016



As we round off the first quarter of 2017, political turbulence and economic uncertainty are becoming the new normal for dealmakers. And while there has been a dip in the M&A Index compared to the past quarter, it has not been as steep as many expected thanks to a rash of megadeals in the consumer and energy sectors.

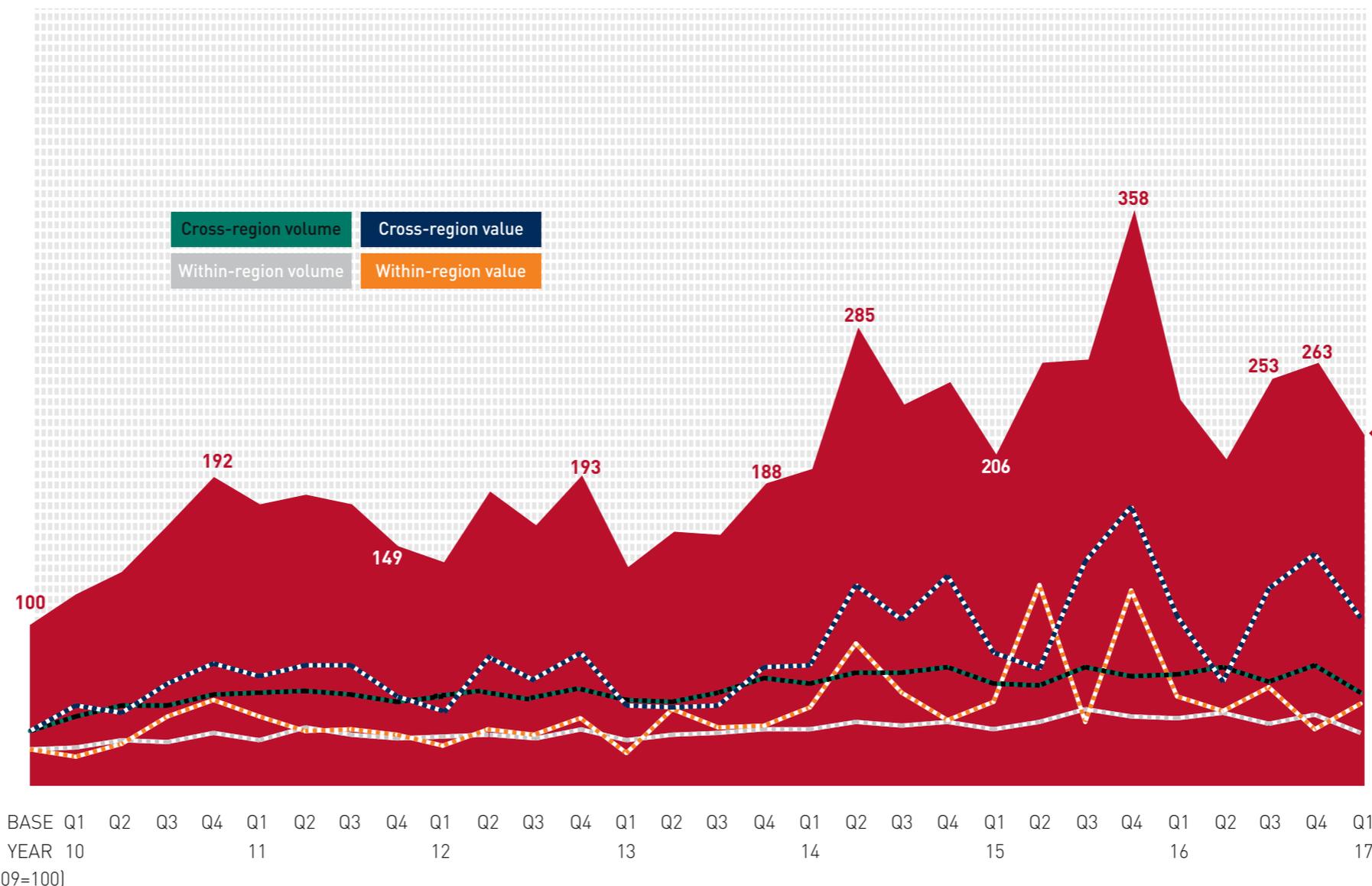
The triggering of Article 50, uncertainty around the Trump administration and bruising electoral campaigns in the EU have coalesced to exert downward pressure on the M&A market in Q1 2017. There were 1,238 cross-border deals worth US\$331.2bn – a fall of 18% in volume but only 3% down in value compared with Q1 2016.

With the drop in volume, it is unsurprising that the Baker McKenzie Cross-Border M&A Index slipped to 218 in the first quarter – down 17% on Q4 2016 and 9% year on year. However, with the exception of 2016, the Index for Q1 2017 is well above all other Q1 figures.

While political issues have provided shaky foundations, it is deal-making fundamentals that have caused the Index to slip. A number of high-profile deals have failed or look doubtful, including Kraft's move for Unilever and the merger between the Deutsche Boerse and the London Stock Exchange. Additionally, there has been a decline in mid-market deals, and outbound activity from China has fallen significantly as the government enforces stricter cross-border deal regulations.

However, despite the challenges, there have been a number of bright spots in the first quarter. On the sector side, consumer leads the way with 142 deals worth US\$113bn – fast-moving consumer goods were highlighted as the sector to watch in the last edition of the Index. The biggest deal of the quarter saw UK-based British American Tobacco agree to acquire the remaining 57.8% stake in US rival Reynolds American for US\$60.7bn. Meanwhile, in the luxury goods sub-sector, French brand Essilor International announced a merger with Italian eyewear specialists Luxottica Group worth US\$25.4bn. Energy and utilities and pharma were the second and third highest sectors in terms of value, contributing US\$51bn and US\$49bn respectively.

While China's retreat from the deal table and the French election make the outlook for Q2 unpredictable, corporate confidence and a rising deal value average – US\$537m, up 15% on Q4 2016 – mean that M&A value should continue to be strong, even if volume remains low.



Cross-Border
M&A Index
Q1 2017
218

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 subcategories, giving slightly more weight to more ambitious deals between parties in two different regions. Regions consist of Africa, Asia-Pacific, the EU, Latin America, the Middle East, North America and Other Europe.

Data correct as of 30 March 2017

2 THE GLOBAL PICTURE

HEADLINES

- 1 Cross-border M&A made up 49% of all deal value and 35% of all deal volume in Q1 2017
- 2 Intra-regional dealmaking value saw a 46% increase quarter on quarter
- 3 Deals from the EU into North America were big news, with US\$98bn spent on 118 deals, including the largest deal of the quarter
- 4 North America was the hot target. The region accounted for more than half of all cross-regional dealmaking, with 206 deals worth US\$120.8bn
- 5 Japan dominates outbound M&A activity from Asia-Pacific

From the inauguration of a new US President to the triggering of Brexit via a fractious election in the Netherlands, Q1 2017 has been far from predictable politically. And the same is true for the cross-border M&A market – North America showed its mettle as a target, the EU slumped, and Japan replaced China as the Asian outbound dealmaking powerhouse.

Shelter from the storm

North America and the US in particular were the hot destinations for deals this quarter.

There were 206 deals valued at US\$120bn – accounting for more than a third of cross-regional volume and half of total cross-regional value. Despite, or possibly because of, the new administration, the US has been seen as a safe haven for deals.

And EU corporates were keen to make large acquisitions stateside. EU businesses spent US\$98bn in North America on 118 deals, including two of the top four deals of the quarter. The consumer sector was

the main driver for deals from the EU into North America with 14 transactions valued at US\$81bn. The biggest inbound deal from the EU was the acquisition of US tobacco company Reynolds American by UK-based British American Tobacco Plc for US\$60.7bn.

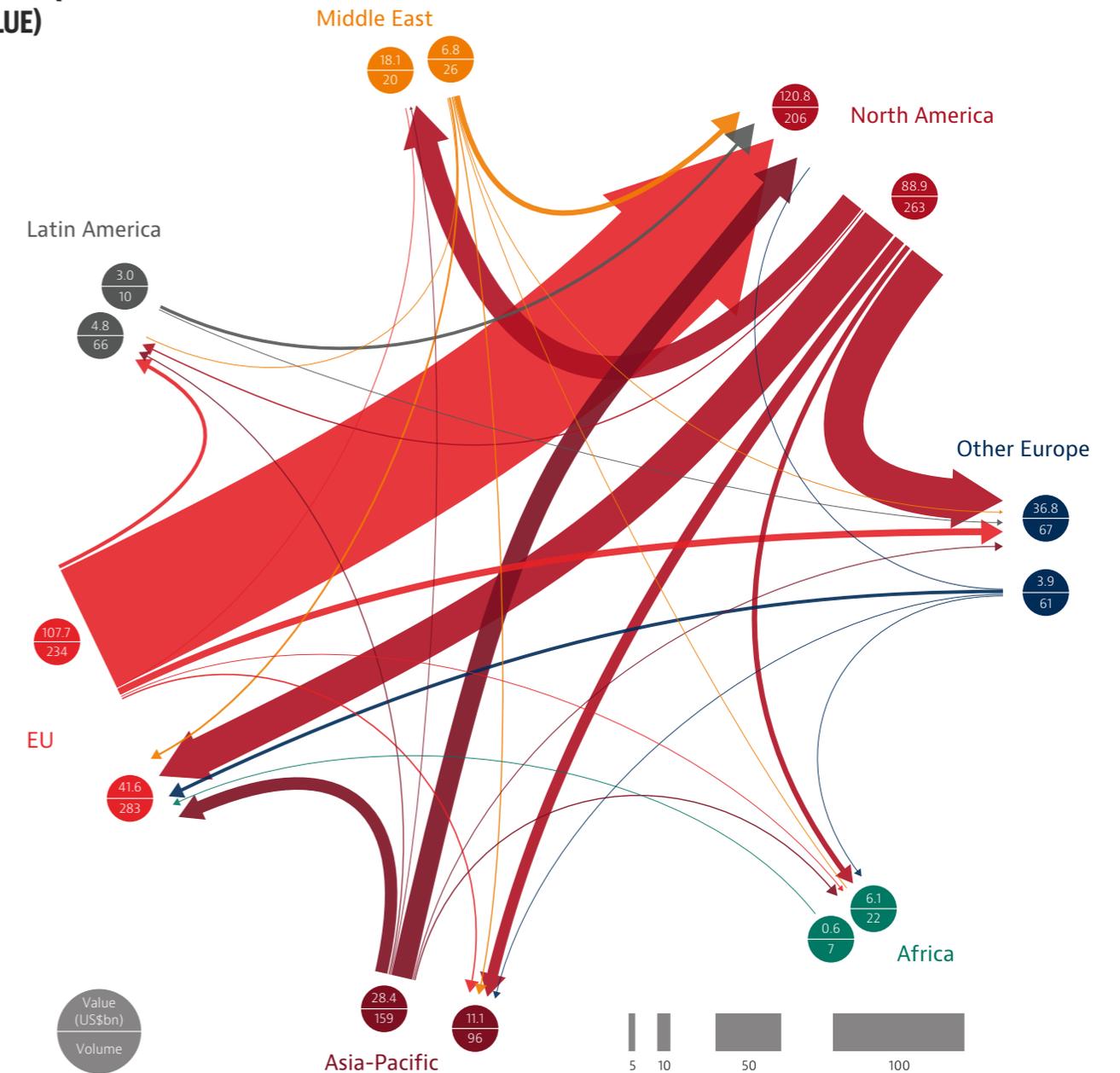
PE props up EU

The fallout from Brexit, economic uncertainty in southern states such as Spain and Italy and a series of contentious election campaigns have hit the EU inbound M&A market in Q1. EU targets accounted for only 17% of cross-regional deal value, compared to an average of 35% since 2009. And almost a quarter of that value figure was propped up by two private equity megadeals out of the US, including buyout group Blackstone's US\$4.3bn acquisition of Aon's benefits outsourcing division. As the EU continues to come to terms with Brexit and a difficult political climate, it will be interesting to note how value fluctuates during the year.

Land of the rising sun

After a strong 2016, Japan has continued its cross-border M&A adventure in the first quarter of 2017. As China retreated from the deal table, due to stricter government regulations, Japan took center stage. Deals were spread across a number of sectors, including financial services, telecommunications and industrials; however, the largest deal came in the pharmaceutical sector, where Takeda Pharmaceutical bought US-based biotech company Ariad for US\$4.9bn. With an aging population, limited opportunities on the home front and less competition from Chinese rivals (for the moment), Japan will continue to be a formidable force in cross-border M&A.

GLOBAL CROSS-REGIONAL DEAL FLOW Q1 2017 (BY VALUE)



3 SECTOR FOCUS: INDUSTRIALS

HEADLINES

1 In 2016, there were 942 cross-border deals in the industrials sector, a post-crisis record. Value also hit a post-crisis high of US\$116.8bn

2 Of the industrial sub-sectors (manufacturing, electronics, industrial products/services, automation, and defense), both products and services and automation saw substantial year-on-year increases

3 China was particularly acquisitive in 2016 with three of the top eleven deals involving buyers from the country

4 There are four key trends that will drive M&A in 2017, and dealmakers need to be ready for them

Despite a febrile political climate, industrial companies have accepted this new normal and are more confident than ever in their deal-making abilities. In 2016, the sector broke post-crisis records – volume was up 2.5% year-on-year while value rose 48% compared with 2015. Both China and the US have been extremely acquisitive. The US was involved in the biggest deal of the year, as Johnson Controls bought Ireland's Tyco International for US\$16.2bn.

There are two main factors driving this current wave of M&A in the sector – confidence and opportunity. "The C-suite is still confident and sees the opportunity in new technology, new regions, new platforms and new growth," says Baker McKenzie partner Dieter Schmitz. "There is also the opportunity where companies see cracks from PE looking to exit and conglomerates looking to do divestitures."

Given this renewed confidence and the resilience to volatility, the deal market is

expected to continue to thrive in 2017, with four specific trends underpinning M&A in the sector – disruption and technological innovation; core competencies and divestments; after-market services; and defense spending.

Disruption drives deals

From automation to robotics and AI, new platforms, models and delivery routes are revolutionizing the sector, and companies need to seize these opportunities now.

"Even the large technology companies need to continue to keep themselves up to date by buying out smaller rivals, who may have a disruptive technology," says Baker McKenzie partner Munir Abdul Aziz.

This is exemplified by the US\$4.3bn transaction which saw Chinese appliance giant Midea take a 95% stake in German robotics company Kuka. Midea hopes that Kuka's advanced technology can help automate existing systems.

A deal with a similar strategy was announced in March this year, as Japan's Toyota acquired the Netherlands-based company Vanderlande, which provides automated handling solutions.

"Industrials have a lot to learn from these smaller, more innovative companies – agility, fluency and alacrity," says Baker McKenzie partner Stephane Davin.

The disruption in the sector is evidenced by the growth of the Internet of Things (IoT). This merging of physical and digital worlds could create up to US\$11trn in economic value annually by 2025, according to McKinsey. It is little wonder, then, that traditional industrial conglomerates such as ThyssenKrupp and GE have IoT high on their agenda.

"Technology, and specifically IoT, will drive M&A," says Baker McKenzie partner Nikolaus Reinhuber. "Industrials have to reshape the way they've been doing things, whether they like it or not."

Back to the core

Industrial groups are also looking inwards. To paraphrase former GE CEO Jack Welch, if the business isn't number one or two in a given sector, then companies are looking to move on. This return to core competency led to a number of big deals in 2016 and will continue to do so, as groups divest unwanted units and bolt on complementary ones. "Companies need to focus on the thing that they're really good at because there are competitors, large and small, that are trying to become more innovative in what they can offer," says Abdul Aziz.

A clear example of this move towards consolidation of core activities came in last year's third biggest deal, which saw German industrial giants Siemens purchase Spain's

TOP FIVE INDUSTRIALS CROSS-BORDER M&A, 2016

Announced Date	Target Company	Target Country	Bidder Company	Bidder Country	Deal Value US\$m
25/01/2016	Tyco International plc	Ireland (Republic)	Johnson Controls, Inc.	USA	16,166
19/01/2016	Waste Connections, Inc.	USA	Progressive Waste Solutions Ltd.	Canada	7,910
17/06/2016	Gamesa Corporacion Tecnologica SA (59% Stake)	Spain	Siemens AG	Germany	7,475
18/05/2016	KUKA AG (86.5% Stake)	Germany	Midea Group Co., Ltd.	China	4,261
21/07/2016	Joy Global Inc.	USA	Komatsu Ltd.	Japan	3,738

Gamesa for US\$75bn. The merger will create the world's largest builder of wind farms.

"Businesses are concentrating on core," says Davin. "European companies such as Safran and Air Liquide, for example, have focused on core activity in their most recent deals."

As companies consolidate and divest non-core divisions, this could present opportunities for PE to move into the market. "Non-core divisions often don't get enough attention," says Reinhuber. "PE can often do a better job at reshaping and growing the business than a conglomerate."

One PE firm that felt it could do a better job was Sweden's EQT Partners which picked up Bilfinger, the German engineering group that provides maintenance services for industrial

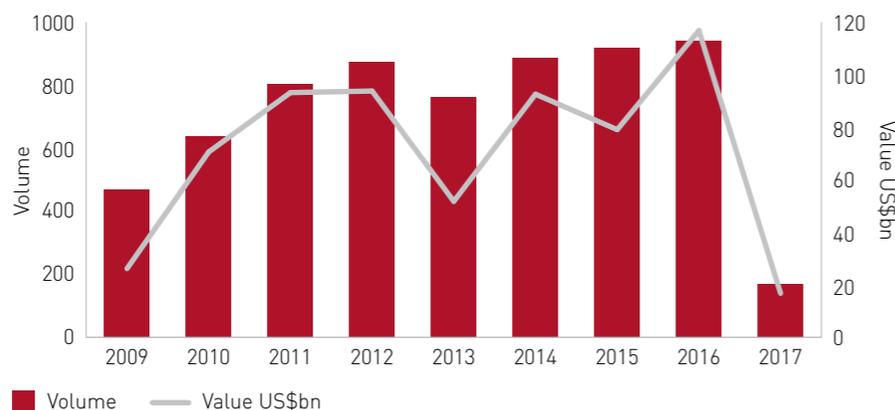
plants, for US\$1.6bn in June 2016.

Service industrials

After-market service has become a major distinguishing factor for companies. It can be an excellent revenue driver. Or as Davin puts it: "After-market service and maintenance is where the gold is."

One recent deals saw all-terrain vehicle manufacturer Polaris buy accessories maker Transamerican Auto Parts for US\$665m in an effort to boost its after-sales service. While it may not drive as much activity as disruption, divestments or core consolidation, it is likely to be part of industrials' strategy in the coming years. "It's difficult to see how it can drive lots of M&A activity," says Reinhuber. "An industrial would have to acquire an after-market company and that goes against

INDUSTRIALS CROSS-BORDER M&A 2009–2017 (YTD)



4 SPOTLIGHT: COMPLIANCE RISKS

focusing on core. However, it is a great recurring revenue driver.”

The defense dividend

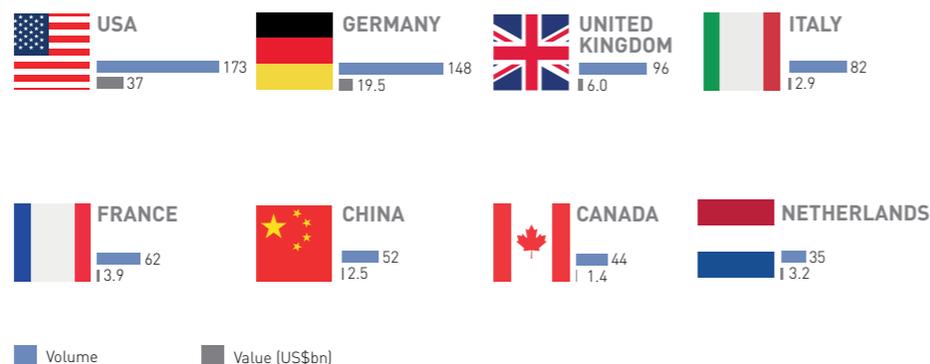
The final driver for M&A in the industrials sector could be defense. In terms of M&A activity, defense has always been something of the poor relation in the industrial sub-sectors. That could be about to change with the announcement that President Trump is proposing a US\$54bn rise in defense spending.

“There are major opportunities in the increased defense spending from a US perspective,” says Schmitz. “This is one of the key areas where the government wants to spend money.”

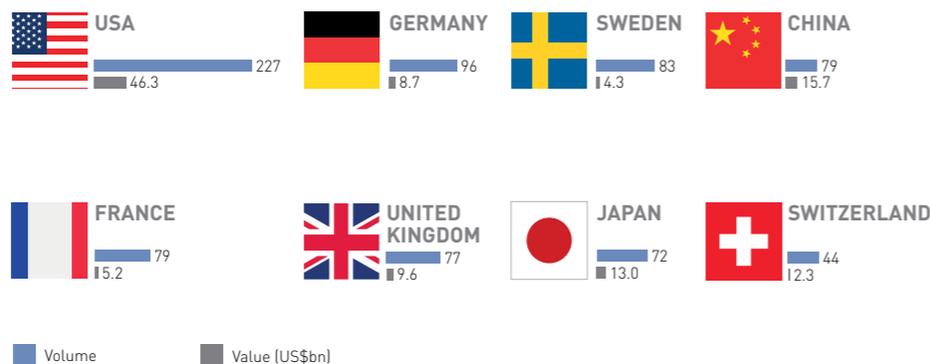
While 2016 was an outstanding year for the industrials sector, 2017 could be just as big – and companies need to be primed and ready to take advantage if the opportunity arises. “Companies need a thoughtful M&A prioritization and execution process,” says Schmitz. “Deal certainty beats price – companies can speed up closing by having financing arranged, regulatory hurdles processed, anti-trust sorted, synergies calculated and integration plotted. Sellers want to get the deal done. This could give corporates the advantage over PE. They need to be ready to move quickly.”

However, companies that want to succeed in the deal market will also need to be more aware of changing regulations and public perception. “The M&A market is becoming more complex. Regulation is increasing with a greater focus on national interest,” says Reinhuber. “M&A players need better stakeholder management and to handle the public much more thoroughly. This could be the differentiating factor for getting your deal over the line.”

MOST TARGETED COUNTRIES WITHIN INDUSTRIALS 2016-2017 (YTD)



MOST ACQUISITIVE COUNTRIES WITHIN INDUSTRIALS 2016-2017 (YTD)



Tips to mitigate compliance risks in M&A transactions

Marc R Paul (Partner, Baker McKenzie, Washington DC) and Karyn Koiffman (Partner, Baker McKenzie, Washington DC and New York) offer their views on the latest US guidelines on compliance risk in M&A.

In February 2017, the Fraud Section of the US Department of Justice (DOJ) published its *Evaluation of Corporate Compliance Programs* (Evaluation Guidance). Based on the Evaluation Guidance and prior DOJ and the Securities and Exchange Commission (SEC) policies, including *A Resource Guide to the US Foreign Corrupt Practices Act* (FCPA Guide), US authorities are interested in assessing:

- **Due diligence:** How M&A due diligence was conducted and whether misconduct or misconduct risks were adequately identified during the diligence process. According to the US authorities, effective due diligence of acquisition targets demonstrates the company’s commitment to compliance, and will be taken into account if the authorities subsequently have to evaluate any potential enforcement action against the company.
- **Effectiveness:** How effectively the compliance function has been integrated into the acquisition process. The DOJ is interested in whether the company’s compliance program is working in practice.
- **Post-acquisition integration:** What was the company’s process for tracking and remediating misconduct risks identified in the due diligence process. Authorities expect the acquirer to promptly incorporate the acquired company into all of its internal controls, including its compliance program.

Steps to mitigate risk

Acquirers are at risk of being held responsible for the historical criminal or civil misconduct of the target company. Due diligence alone may not provide full protection from successor liability, but it will mitigate the risk.

- **Understand the risks:** An assessment of the compliance risk profile of the target company can be done reasonably quickly and will determine what level of due diligence is necessary.
- **Tone at the top:** One of the most important issues to look out for is the “tone at the top” at the target company. If high-level executives are reluctant to submit to a short interview to provide information for the risk assessment, that should raise some doubts about the culture at the company.

- **Internal controls testing:** Standard financial due diligence may not be sufficient to test the efficiency of internal controls. The utilization of forensic accounting professionals should be considered if the compliance risk profile of the target warrants it, and such professionals should be hired by counsel in order to protect their work product under legal privilege.
- **Globalization impact:** Local anti-corruption laws have been enacted in various countries in the last few years, and government authorities across the world are cooperating with each other. The deal team should identify the countries involved, the risk environment in those countries, and what laws/regulations are applicable in those jurisdictions.
- **Supply chains:** A corruption problem not directly affecting the target company but affecting a main customer or supplier of the company may affect the valuation and prospects of the target business.
- **Third-party risk:** When third parties are involved, the company should review agreements with key agents going back several years, looking at commissions, payments and any irregularities.
- **Compliance integration program:** Tackling due diligence efforts early on is not only important to confirm that the target company is compliant, but also an important step to allow the company to prepare a plan to roll out a compliance integration program on day one after the acquisition.

Robust compliance diligence minimizes risks

No acquirer expects to have compliance problems in its own business or in acquired businesses. We have developed a matrix system that analyzes the risk profile of the target company based on the type of business model, industry, geographic location and governmental touch points. It is fine to expect the best, but prudent to plan against risks.

Baker McKenzie is the No. 1 cross-border M&A firm. Over the past ten years, we have completed more cross-border M&A transactions than any other law firm. In addition, it is the tenth year in a row the firm has been ranked No. 1 for deals involving emerging markets. With more than 1,300 M&A lawyers in 77 offices globally, we have one of the largest and most-active M&A practices in the world.

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