ALLEN & OVERY

Insights, **Q4 2016**

Contents

Down but not out

Deal values and volumes remain significantly down on the record levels achieved in 2015, but roughly on a level with 2014. That is a pretty remarkable outcome given the huge political uncertainty caused by Donald Trump's election victory and Brexit.

Q4 KEY THEMES INCLUDE:

VALUES AND VOLUMES DOWN BUT NOT OUT

Transaction values and volumes continue to be significantly down on 2015, when deals reached record levels. But they remain roughly on a par with 2014 and deal values in the year to date have exceeded USD2.5 trillion for the third year running.

POLITICS TAKES ITS TOLL

Transaction markets grew progressively quieter as the year unfolded, with some – notably Europe and Asia Pacific – considerably less active in Q4. Above all, this reflects investor nerves about the deepening political and economic uncertainty caused by a number of factors, including the UK's vote to leave the EU and the U.S. election result. Dealmakers seem determined to take time to assess the new political landscape.

OCTOBER SPIKE FOR THE U.S.

Despite the lower levels of transactions in the U.S., there is still evidence of real strength in the market and October witnessed an unusual spike in U.S deals. They rose to their highest monthly level on record, with four of the ten biggest deals this year done in that month. We think this reflects a continuing appetite amongst CEOs to take on truly transformative, strategic deals that will allow them to achieve revenue and profit growth in a low-growth environment. So far, the election of Donald Trump does not appear to have changed that view although any interest rate rises might.

MEGA DEALS DECLINE AS MID-SIZED TRANSACTIONS DOMINATE

The overall volume of deals worth more than USD10 billion is 35% lower than in 2015, yet megadeals continue to be announced, as seen in Q4 with the proposed AT&T/Time Warner merger. But in some regions, notably the U.S. and Asia, we've seen good growth in mid-market deals.

COMPLEXITY AND REGULATION FORCE RECORD WITHDRAWALS

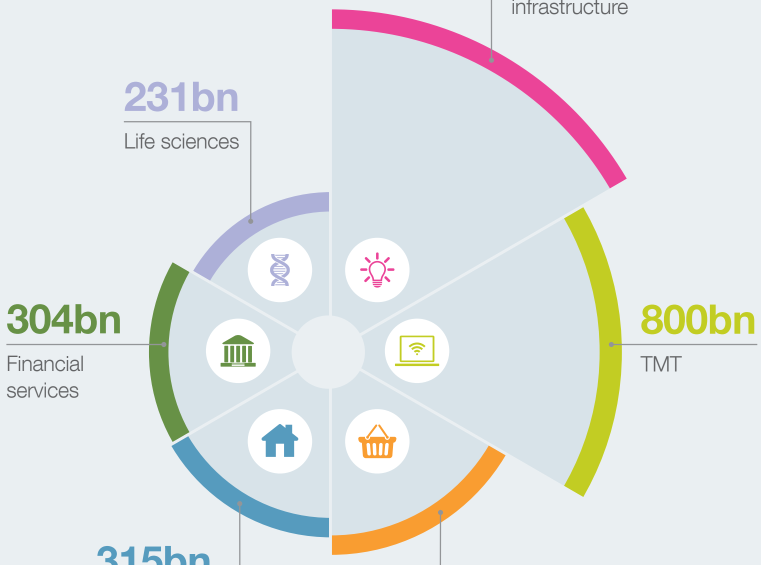
The value of withdrawn deals has risen to an eight-year high of USD771bn in 2016, a reflection of increased activity by antitrust regulators but also the daunting complexity of some of the huge strategic deals being undertaken. The sectors most affected are high tech, financial services and industrials.

SECTOR STRENGTHS

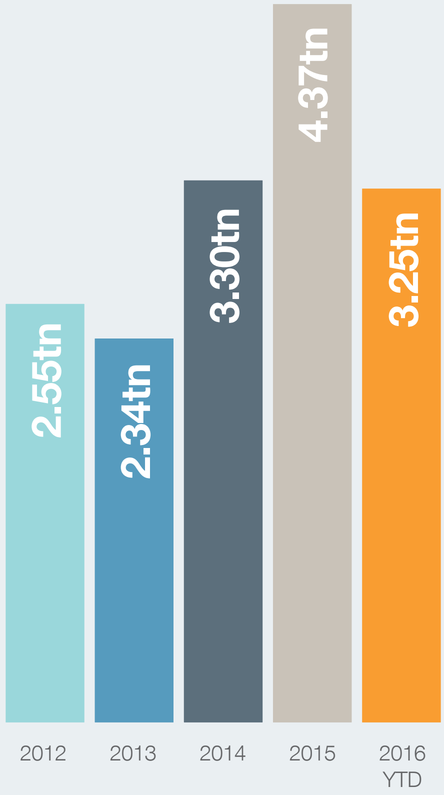
Energy and infrastructure showed some rare signs of resilience during 2016, although this is partly due to a small number of very large deals and against a backdrop of continuing low oil prices, which are likely to persist. Cost cutting, capacity reduction and more stable prices for key commodities could begin to spark activity in the mining sector after several very depressed years. Life sciences and TMT transactions, both significant drivers of the 2015 boom, are sharply down, although we expect activity to pick up in both sectors in the year ahead.

Global M&A in numbers 2016

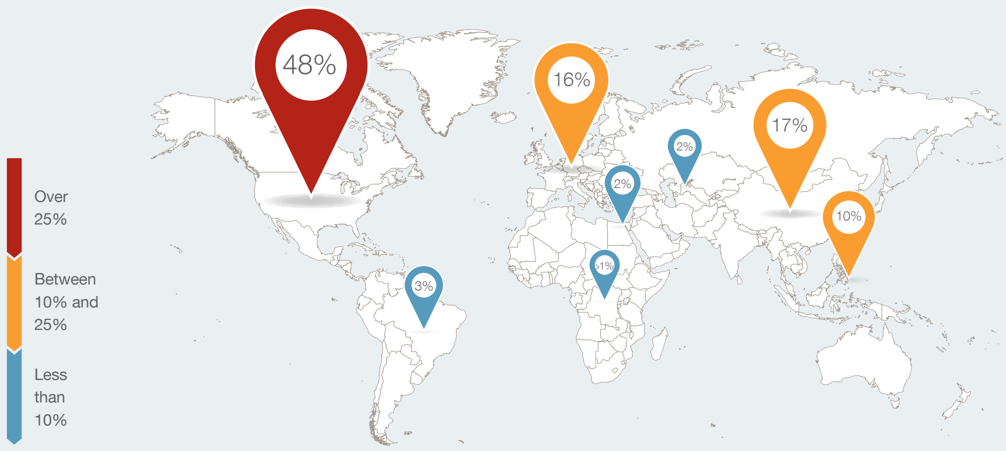
Top six sectors by value (USD)
Jan-Nov 2016



Global deal values (USD)



Deal values by region
Jan-Nov 2016



Region	% of deal value by region
U.S.	48%
Greater China	17%
W Europe	16%
APAC (excl. China)	10%
Latin America	3%
MENA	2%
CEE and CIS	2%
Sub-Saharan Africa	>1%
Other	2%

Data provided by THOMSON REUTERS

Note: These figures represent deals announced between 1 January 2016 and 30 November 2016.

In focus: Fix it first

Overcoming obstacles to international deal flows

The record number of withdrawn deals in 2016 reflects both a greater level of intervention from merger control and foreign investment control authorities, as well as the growing complexity of strategic transactions. Dealmakers increasingly need to plan ahead for merger reviews and, if need be, consider offering remedies at an early stage.

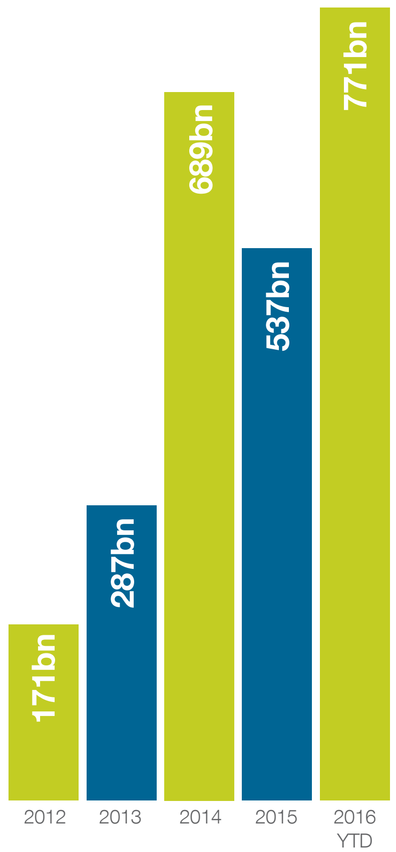
While the proliferation of strategic, big ticket transactions in the last two years has driven the value of completed global M&A deals to record highs, it has also resulted in more significant deal failures. Indeed, in 2016 the value of withdrawn deals rose to an eight-year high of USD771bn, a clear indication of just how difficult it can be to pull off significant, often multi-jurisdictional, transactions.

Not all deal withdrawals are a result of antitrust issues, of course. But many are and, from a competition perspective, two factors are at play here. Firstly, merger control authorities across the world are taking an increasingly aggressive line on in-market consolidations. Secondly, with more than 100 jurisdictions now having merger control regimes in place, the antitrust landscape has certainly become more challenging to negotiate for parties looking to execute complex, cross-border, M&A deals.

With organic growth hard to come by in a difficult macroeconomic environment, boardrooms are under huge pressure to accelerate expansion in other ways. Often, acquiring a competitor is the quickest way to achieve tangible merger synergies and thereby drive shareholder value. Linked to this, a consistent trend across sectors in recent years has been a willingness by companies to shed non-core assets and then to consolidate and shore up their market position by acquiring a rival in the same or a closely related market.

However, given the concentration of market power arising from these strategic transactions, merger control authorities are becoming more willing to intervene and, in the absence of merging parties identifying and offering appropriate remedies, ultimately block such transactions.

Value of withdrawn deals (USD)



Note: The 2016 YTD figures represent value of deals withdrawn between 1 January 2016 and 30 November 2016.

Data provided by THOMSON REUTERS

Planning ahead

Against this backdrop it's important for dealmakers to establish a more pro-active relationship with antitrust authorities when contemplating complex transactions that lead to market consolidation. That means planning ahead carefully, identifying the likely areas of competition concern and – where necessary – lining up potential remedies well in advance.

We are seeing this more and more with our clients who understand the value of dedicating time to identifying potential areas of concern and, where appropriate, entering into remedy discussions with antitrust authorities at an early stage in their review timetable. Indeed, with a number of capital-intensive sectors seeing an ever increasing consolidation of market power, it now often makes sense for dealmakers to be upfront with merger control authorities and consider an early offer of remedies to address any potential competition concerns.

That's all the more important at a time when antitrust authorities seem to be taking a far more rigorous and time-consuming approach to assessing the viability of remedy proposals. Certainly that's been the trend in investigations by both the U.S. Department of Justice and the U.S. Federal Trade Commission. And the latter is close to finalising a significant review into the effectiveness of 90 remedies it imposed between 2006 and 2012, which may further increase the level of scrutiny of remedy proposals.

Some two thirds of deals going into an in-depth, second phase investigation in the U.S. (a so-called "second request") will require remedies – which means that only 30% of transactions go through unconditionally. Increasingly, therefore, the presumption must be that remedies will be required in such cases.

In the U.S., the majority of remedies involve a divestiture to an identified upfront buyer, backed by unconditional agreements, which is typically required to close within ten days of the main deal, putting the onus on the parties to line up the remedy taker at an early stage.

In transactions that raise significant competition issues, the European Commission (EC) and EU Member State national merger control authorities are increasingly following the approach of their U.S. counterparts in seeking an upfront buyer remedy structure. This ensures that, before the main deal can close, the relevant authority has an opportunity to review and approve both the suitability of the proposed remedy taker and the commercial agreements to the underlying divestment.

Dealmakers in complex cases are increasingly turning to so called "fix it first" remedy structures, which involve negotiating and agreeing a divestment to a potential remedy taker in advance

However, this approach can give rise to increased deal uncertainty for the parties to the main transaction, especially where there is a limited pool of potential buyers.

For this reason, dealmakers in complex cases are increasingly turning to so called "fix it first" remedy structures, which involve negotiating and agreeing a divestment to a potential remedy taker in advance, thereby allowing the relevant merger control authority to approve that remedy package in its clearance of the main transaction. This means that the remedy and closing of the main deal can be implemented almost as soon as the main deal is approved, increasing overall deal certainty and minimising the risk of losing value through a worst-case fire-sale divestment scenario.

> "It makes sense for dealmakers to be *upfront* with merger control authorities and consider an early offer of remedies."

The merger of U.S. tobacco makers Reynolds and Lorillard in 2015 is a great example of this approach, with Imperial Tobacco acting as remedy taker, picking up five brands from Reynolds and Lorillard, as well as Lorillard's factory and most of its workforce. Obtaining approval of a USD25bn merger with a USD7bn package of upfront remedies took many months of careful preparation and negotiations with the antitrust authorities, but ultimately proved to be a huge success.

Similarly, this year's merger of VimpelCom and Hutchison's respective mobile telecoms businesses in Italy was cleared by the EC on the basis of a fix it first remedies package involving the creation of a new fourth mobile network operator in Italy (the first time such a remedy has been offered in an EU merger review). And, in recent weeks, we have seen medical device makers Abbott and St Jude agree to sell some of their cardiovascular products to Terumo of Japan to try to secure approval for their proposed USD25bn merger.

Regardless of the structure of the remedy package, however, careful analysis and some fine judgements are required when identifying and proposing a suitable remedy taker to merger control authorities.

For instance, the remedy taker cannot be one where the acquisition would give rise to further competition concerns (which in already concentrated markets may rule out trade buyers). But, at the same time, the merger control authority will insist that the remedy taker has the capability and incentive to compete effectively in the market (which sometimes means that pure financial buyers are not deemed suitable).

For this reason, it is increasingly important for merging parties to agree at an early stage in commercial negotiations who will carry the antitrust risk – and detailed merger control risk sharing and cooperation provisions are now commonplace in M&A agreements.

> Careful analysis and some fine judgements are required when identifying and proposing a suitable remedy taker to merger control authorities

The global and the local

Merger control regimes have spread rapidly in recent years, with more than 100 jurisdictions now having regulations in place backed by suspensory powers. That means that if a mandatory filing is triggered, a deal cannot proceed without the clearance of the relevant antitrust authority.

Managing remedies in this multi-jurisdictional context can be challenging and will depend on the nature of the markets involved. If the antitrust concerns involve global markets, the remedies will often need to be global, with the most stringent antitrust authority setting the bar, whilst concerns involving local markets may be solvable with local remedies, tailored to particular jurisdictions. Although this undoubtedly complicates the process of gaining clearance for a cross-border transaction, in reality, antitrust authorities typically do not interfere (through the imposition of remedies or a prohibition) unless the deal has a close nexus to their jurisdiction and will give rise to material competition concerns.

There have been some instances, however, where MOFCOM, China's antitrust authority, has appeared to stretch beyond its jurisdiction, in particular in the early days of the merger control regime in China.

This continues to fuel a slight misconception about MOFCOM's interventionist tendency. In truth, MOFCOM last prohibited a deal in 2014. It made just two conditional clearances in 2015, and only one so far in 2016, with possibly another one or two expected before the year-end. However, it is true that parties to a transaction are advised to inform MOFCOM of a proposed deal at an early stage and this makes commercial sense, not least given that MOFCOM's clearance procedures tend to be lengthy, stretching from two to three months at best to, in some cases, a year.

MOFCOM's approach is also different from that of the EU and the U.S. merger control authorities in two key respects. Firstly, it tends to favour behavioural remedies (that is, changes in market practice) over divestments. In addition, it is obliged to apply an industrial policy as well as a competition lens to its decisions. We saw this at the end of 2015 when it cleared the Nokia/Alcatel merger only after demanding behavioural remedies over the fair licensing of standard technology patents to ensure a level-playing field for Chinese manufacturers.

Interestingly, applying industrial policy considerations to reviews of cross-border mergers may no longer be quite such a distinguishing feature of Chinese merger control.

Brexit and UK Government intervention

Following the UK's June 2016 EU referendum, Theresa May announced in a speech two days before her appointment as Prime Minister that a *"proper industrial strategy wouldn't automatically stop the sale of British firms to foreign ones, but it should be capable of stepping in to defend a sector that is as important as pharmaceuticals is to Britain".*

This has been widely received as a signal that, post-Brexit, the UK Government will be more inclined to apply industrial policy considerations to cross-border mergers and overseas investment to protect UK national interests.

Currently, the ability of the UK Government to do so is constrained by EU merger control laws, as well as EU laws guarding the free movement of capital and freedom of establishment. As with many other questions, the extent to which this will change post-Brexit will depend on the model of Brexit eventually adopted.

If the UK leaves the EU but remains a member of the EEA, for example, those same EU laws will continue to apply and there would be no material change to the legal position (although the UK Government may feel more empowered politically to 'push the envelope' of permissible intervention than it has to date).

Conversely, if the UK exits both the EU and the EEA then those restrictions would fall away. In that scenario, the scope of UK Government intervention in a cross-border merger or in-bound overseas investment may depend on the terms of post-Brexit bilateral trade and investment agreements between the UK and its trading partners (including, but not limited to, the EU).

Following its decision to press ahead with the Hinkley Point C nuclear project, in September 2016 the UK Government subsequently announced *"reforms to the Government's approach to the ownership and control of critical infrastructure to ensure that the full implications of foreign ownership are scrutinised for the purposes of national security [including] the introduction of a cross-cutting national security requirement for continuing Government approval of the ownership and control of critical infrastructure".*

While there remains a high degree of uncertainty as to what form Brexit will eventually take, if it involves an exit from the EEA as well as the EU, this would seem to suggest that acquirers of businesses in strategic sectors meeting both UK and EU merger control thresholds should be prepared for the possibility of three parallel reviews: on competition grounds under EU and UK laws in Brussels and London respectively, and, potentially, also on the basis of an expanded UK public interest test.

Regions

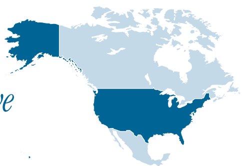
Insights, **Q4 2016**

Regional insights

Deal activity across many regions is down sharply on 2015, but many markets remain fundamentally robust with signs that investors are adjusting to life in a significantly more uncertain political environment.

U.S.

CEOs hold their nerve



While the U.S. M&A market continues to trail the fast pace set in 2015 (both in terms of the number of transactions and the size of the deals), October was a record-breaking month, with almost USD250bn of announced transactions. Some noteworthy deals announced during the last ten days of October included the USD85bn AT&T/Time Warner deal, Qualcomm's acquisition of Dutch semiconductor manufacturer NXP for USD47bn, BAT's USD47bn offer to acquire the publicly-held shares of tobacco company Reynolds American, the GE-Baker Hughes oilfield services combination and, in the telecoms sector, CenturyLink's acquisition of Level 3 for USD34bn.

The announcement of these transactions in late October, immediately before the U.S. presidential election on 7 November, suggests that concerns about the effect of election-related uncertainty on the U.S. deal market were overblown.

Following Donald Trump's victory, there was a powerful rally in the U.S. equity markets, with the Dow Jones rising over 5% for the month and hitting record levels. This disproved a widely-held view that a Trump victory would trigger a broad sell-off in the markets. Traditionally there has been a strong correlation between the equity market levels and M&A activity. When the markets are high, CEOs are more confident and ready to buy and sellers are more comfortable selling.

It is difficult to predict with certainty whether the Trump administration will be "good" or "bad" for the deal markets. Traditionally, a Republican president, coupled with Republican control of both houses of Congress, would suggest a pro-business environment with limited regulation. But, as has been widely observed, Donald Trump is not a conventional Republican.

He has expressed hostility to trade agreements and to cross-border tax driven "inversions" and has indicated an intention to oppose some large media mergers on antitrust grounds. On the other hand, his early choices for cabinet positions suggest a more moderate administration on economic issues than the expectations that arose from his campaign rhetoric.

For now, the U.S. deal pipeline looks robust – and we continue to see a market dominated by strategic deals that are transformative in nature

In any event, we continue to believe that the health of the M&A market is less influenced by the ambient political environment and more influenced by the traditional drivers of M&A activity – the need to show growth in a low growth macro-economic environment, and the ability to increase profitability by realising synergies. We believe these drivers will continue to propel M&A activity in the coming months.

If there is one cloud on the horizon, it is the prospect of higher interest rates. The Federal Reserve Board is scheduled to meet in December. If we have an increase in interest rates that is sustained and significant, it could put a brake on activity. A more modest move by the Fed is unlikely to cause a significant deal slowdown.

But, for now, the U.S. deal pipeline looks robust – and we continue to see a market dominated by strategic deals that are transformative in nature (and not simply transactions that rely on financial engineering to create value), which bodes well for future activity.

ASIA PACIFIC (INCLUDING GREATER CHINA)

Stemming the flood

A remarkable feature of the global M&A market in 2016 – and one that continues at full throttle – is the explosion of outbound transactions by Chinese investors in markets right across the world, but particularly in Europe and the U.S.

In the year to date we've seen extraordinary levels of Chinese investment pour into overseas markets with an increasingly diverse range of sectors being targeted. Q4, for instance, saw not only continued investments by Chinese companies in energy, power and infrastructure, but also in hotels and hospitality, high tech and financial services.

This outflow of capital is, however, causing growing concern for the Chinese Government, which is now looking to impose tougher controls on outbound investment amid fears that it is accelerating the depreciation of the renminbi, which has lost some 6% of its value against the U.S. dollar this year.

On 6 December, officials from The People's Bank of China, The State Administration of Foreign Exchange (SAFE), The National Development and Reform Commission, and MOFCOM expressly stated in a press conference that regulatory authorities will pay close attention to 'not well rationalised' outbound investments by PRC investors in real estate, hotels and hospitality, movie theatres, entertainment, and sports clubs, among others.

Reports suggest that SAFE is drawing up new rules that will allow it to scrutinise outbound deals worth more than USD10bn much more carefully, even those that have won prior approval. Acquisitions of assets outside a company's core business, and worth more than USD1bn, are also said to be under the microscope, as are real estate investments worth more than USD1bn by state-owned enterprises.

> We've seen extraordinary levels of Chinese investment pour into overseas markets with an increasingly diverse range of sectors being targeted

Other types of outbound investments that are reported to be subject to stricter scrutiny include investments made by limited partnerships, minority (less than 10%) investments in overseas listed targets and investments resulting in high debt to asset ratio of the Chinese investor. While this largely formalises rules already in place, it does signal the seriousness of the authorities' approach to the issue.

> This outflow of capital is causing growing concern for the Chinese Government, which is now looking to impose tougher controls on outbound investment

The question is: will this action lead to a significant drop in overseas transactions?

Some commentators are speculating that it will and certainly the new controls will put Chinese buyers under pressure in competitive auction scenarios, where sellers are looking for completion certainty. Overall, we expect Chinese outbound M&A to continue, even if there is a fall off in mega deals, with an ongoing stream of mid-sized transactions which look likely to escape increased scrutiny.

On the inbound side, currency depreciation is also having a significant impact on foreign investment in China's real estate market. Currency appreciation in the past always made such investments a pretty safe bet, guaranteeing good returns even if property prices did not increase. That is no longer the case.

Against that background we've seen more and more long-term investors, such as sovereign wealth and pension funds, move into a market once dominated by shorter-term PE investors, because they have the firepower and the return expectations that allow them to ride out economic cycles.

While China's growth is continuing to slow down, it is doing so in a controlled and steady manner. Although there is some risk in terms of bad debts, the danger of a hard landing – a prospect that has rattled investor nerves across global markets in 2016 – seems to have diminished. That bodes well for continued high levels of activity in the year ahead.

> "While China's growth is continuing to slow down, it is doing so in a controlled and *steady* manner."

Elsewhere in the region, a standout Q4 deal was the part sale of Ausgrid, the electricity transmission system serving New South Wales, to two large Australian pension funds for nearly USD12.5bn. The deal was clinched after earlier offers from Chinese and Hong Kong investors were blocked by the Foreign Investment Review Board on national security grounds.

Potential investors in key infrastructure assets are now operating on the expectation that foreign bids will be given greater scrutiny in future, but we do not think this will deter them and we expect to see further privatisations in 2017.

Australia's IPO market has been noticeably quieter in recent months with a number of listing processes either deferred, halted or instead resulting in trade sale. A reflection both of some fairly steep price expectations and market jitters caused by the Brexit vote and the U.S. election. For instance, the sale of Moly-Cop, one of the healthy assets rescued from the collapse of steelmaker Arrium, was being run as a dual-track process but was eventually sold to the PE fund, American Industrial Partners, for USD1.2bn.

Key markets in the ASEAN region remain busy, not least Vietnam where the Government is preparing to announce the sale of stakes in a range of state-owned businesses. There are also signs of investor confidence returning in Indonesia after a long quiet spell.

There is a strong pipeline of deals in the Philippines, particularly in financial services, infrastructure and power, with no sign that President Duterte's outspoken leadership style is deterring investors. Q4, for example, saw Therma Power, part of the giant Aboitiz Power Corp, fight off strong competition from rival overseas bidders to take control of the power interest of GNPower from Blackstone in a USD1.2bn deal.

By contrast, Malaysia and Thailand, still in the throes of political upheaval and now living through further uncertainty following the death of the King, remain very quiet in terms of transactions.

WESTERN EUROPE

Marking time?

While the statistics point to a significantly higher decline in deal activity in Western Europe than in other markets, notably the U.S., they belie both a continuation of fairly significant transactions, considerable behind-the-scenes activity and a relatively powerful pipeline of upcoming deals.

None of this should be particularly surprising given the long shadow being cast over the region by Brexit, although it's fair to say many investors expect this to be an issue that will not only take some time to resolve but one whose economic effects will not start to be fully felt until the back end of 2017.

We are seeing some impact from this political uncertainty, of course, with the UK's share of global transactions sinking to an all time low this year.

And the spectre of more trade barriers going up in both the UK and the U.S. after Donald Trump's election victory is causing some companies to take stock in a way that may well have a contradictory impact on the M&A market.

Why, for instance, would a German car-maker want to maintain a UK manufacturing operation fed by a disrupted European supply chain? On the other hand, if the U.S. does take a more protectionist stance, does it make sense to establish a self-supporting operation the right side of those newly imposed trade barriers?

Other uncertainties are weighing on European investors' minds, not least the likely direction of U.S. interest rate policy and whether that will force the European Central Bank to rein in its quantitative easing policy and push rates up too.

All these are difficult questions to answer and may be forcing investors to mark time. Nevertheless we are continuing to see some strong activity in key markets.

There have been a string of strategic transactions in the Dutch market, including Qualcomm's bid for Netherlands-based NXP Semiconductors. The insurance sector has seen Delta Lloyd approached by NN in a EUR2.4bn takeover, while the Belgian postal operator bpost continues to court PostNL with an increased, but so far rejected, EUR2.5bn takeover offer.

The result of the Italian referendum on constitutional reform, which aimed at increasing the powers of Italy's lower house, the Chamber of Deputies, is not likely to have far-reaching effects on the active M&A market in Italy. We have seen growing activity by PE funds in Italy looking to acquire iconic "made in Italy" assets and an increase in outbound deals by Italian investors.

Inbound investors, notably from the U.S., China and Japan, continue to scout for deals in the UK, Netherlands and Germany, targeting both large and mid-size companies. Germany saw more Chinese investment in Q1 of 2016 than in the whole of 2015 and that interest continues at full tilt.

That's not always without controversy as we've seen with the proposed buyout of Aixtron, maker of dual-use semiconductors, by Chinese buyers. The deal has been blocked by U.S. authorities on national security grounds, after it had already been called in for review by The German Ministry of Economics. It remains to be seen if this will begin to dampen Chinese interest in key sectors.

Boardrooms remain in confident mood, despite the political uncertainties, and ready to do highly strategic deals. Bayer's giant bid for Monsanto – the biggest German outbound investment ever, and the largest cash only offer on record – is still progressing although an acquisition of this size obviously requires significant work in terms of implementation and regulatory approval. Q4 also saw France's Total sell its Atotech speciality chemicals business for USD3.2bn to the U.S. PE fund, Carlyle.

From a UK perspective, although our internal pipeline of transactions both in private and public M&A is very strong going into Q1 2017, our sense is that this might not be reflective of the wider M&A market, particularly in terms of UK public M&A.

The UK financial services and energy markets remain quiet, though increasing confidence in commodity pricing and the recent OPEC agreements may help to re-ignite deal making in the resources sector more generally. We also expect to see further deal making in the TMT sector as businesses continue to use M&A to protect and gain market share in the face of continued technological developments.

CEE AND CIS

Pockets of growth despite jitters

It was another mixed quarter for the CEE region, with strong growth in Poland and livelier activity in the Czech Republic. Some significant deals have been announced, including AB InBev's sale of five eastern European beer brands to Japan's Asahi Group for EUR7.3bn. Elsewhere in the region, however, there is evidence that planned deals are being delayed as investors take stock of current economic uncertainties.

As we predicted in our last edition, the Polish market has been at its busiest for many years. October started with Naspers agreeing to sell Grupa Allegro, the leader in e-commerce in Poland, to a consortium of PE funds, including Cinven, Permira and Mid Europa for USD3.25bn – the second largest M&A transaction in Poland ever.

Liberty Global also announced plans to buy its rival Multimedia for USD760 million, while PKO BP, the largest Polish bank, agreed to buy Raiffeisen Leasing from Raiffeisen Bank International.

The prospects for the first half of 2017 are also promising. PZU is expected to join forces with the Polish Development Fund (Polski Fundusz Rozwoju), to buy Unicredit's stake in Bank Pekao, the second largest Polish bank. The French power giant EDF has entered into exclusive negotiations with IFM Investors to sell its Polish operations and Engie should soon announce buyers for its Polish business.

Other deals coming to the market are likely to include the sale by Mid Europa Partners of Zabka, a retail chain, in a deal which may raise EUR1bn for the PE fund, and Mid Europa Partners is also expected to kick off the sale of laboratory chains Diagnostyka (and Alpha Medical in the Czech Republic) in Q1 of 2017.

The Polish market has been at its busiest for many years

After a relatively quiet Q3, there are renewed signs of life in the Czech Republic with a notable spike in interest from Chinese investors. November saw the second Czech/China Investment Forum staged in Prague, with Chinese investors said to be focusing particularly on the real estate, engineering and logistics sectors. Ties between incumbent mobile operator Czech O2 and China Telecom are also said to be strengthening following the signing earlier this year of a data services co-operation agreement.

> “A mixed quarter for the CEE region, with planned deals delayed as investors *take stock* of economic uncertainties.”

Macquarie also chose Q4 to make another of its investments in the country, leading a consortium that is buying a 30% stake in EPIF, the gas and power transmission and storage business of EPH, the privately owned energy company serving both the Czech Republic and Slovakia.

Current political uncertainties appear to have caused a new bout of jitters in some SEE markets, particularly Serbia, Bulgaria and Croatia. Whilst deal pipelines remain robust, it seems that investors are taking a wait and see approach and pushing transactions back into 2017.

The implications of Donald Trump’s election victory are a significant talking point in Russia

Some deals are still getting done. Q4 brought news of the sale of the glass container business of Yioula to BA Vidro by its Greek owners. Meanwhile, Enterprise Investors announced that it has signed an agreement to sell Profi Rom Food, the largest supermarket chain in Romania, to Mid Europa Partners, for an equity value of EUR533m, making it the largest deal ever completed by a private equity fund in Romania and the largest retail deal in the country’s history.

The Hungarian Government appears to have changed tack in its long-running strategy to renationalise key assets, thanks it seems to budget constraints rather than a change of political heart.

Having already taken back control of the gas transmission network, it has now decided not to do the same for the electricity system, leaving a question mark over whether outside investors, including RWE and E.ON, will now sell their interests in the country.

The implications of Donald Trump’s election victory are a significant talking point in Russia. But the business community is very cautious about how positive this could be for the Russian market and believe that speculation in the West that it is good news for Russia is somewhat exaggerated. The consensus for now seems to be that, even if it does lead to slightly warmer relations, there is little chance it will result in U.S. sanctions being completely lifted any time soon or in an immediate stream of new U.S. investment.

With economic conditions still depressed, the Government is pressing on with its privatisation programme, although with some significant controversy. In November, Economy Minister Alexei Ulyukayev was charged with allegedly accepting a USD2m bribe in connection with clearing the Rosneft USD5.3bn acquisition of a 50% stake in rival oil and gas company Bashneft.

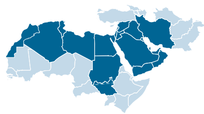
The Bashneft privatisation was eventually done at high speed and was by no means run as a conventional M&A process. Rosneft now has a mandatory offer for the rest of the shares.

But now attention has turned to the privatisation of Rosneft itself, with the State set to sell EUR10.2bn in Rosneft shares. Qatar Investment Authority and Glencore have announced that they will invest EUR2.5bn and EUR300m respectively to buy a 19.5% stake in the company, with financial institutions including Italy’s Intesa Sanpaolo providing the debt financing for the remainder of the deal. This marks the largest foreign investment in Russia since the crisis in Ukraine in 2014.

Russia continues to seek new trade and investment ties with other regions to counteract the effect of U.S. and EU sanctions. Significantly, Q4 saw India’s ONGC take an 11% stake in Russian energy company Vankorneft and Rosneft lead a consortium paying USD13bn to take control of refinery and port operations from India’s Essar Group.

With the Government needing to raise fresh finance it would not be surprising to see further privatisations in 2017, again targeting Asian and Middle Eastern investors.

MIDDLE EAST AND NORTH AFRICA



Caution prevails despite growth

Deal values in the region were up against the same quarter last year, with movement in the consumer, telecoms and financial sectors. Caution prevails however, as the background of global uncertainty and slowdown leads to funds being utilised more strategically in an effort to ensure long-term value.

Whilst domestic deals lead the market, there is still cross-border activity as the trend towards diversification and cost saving continues.

In particular, there is evidence of ongoing interest by Middle East investors in assets in Africa and the growing importance of the Middle East to the Africa investment corridor. The market in North Africa especially looks healthy, with Morocco and Egypt leading the way. Improved infrastructure and access to credit look set to fuel activity there in the medium term.

> Whilst domestic deals lead the market, there is still cross-border activity as the trend towards diversification and cost saving continues

Against the backdrop of lower oil prices, sovereign wealth funds in the GCC region continue to look for more international investment opportunities. Such partnerships hold the promise not only of a move away from oil reliance, but also access to expertise, technology and know-how which may not be readily available in the region.

In one of the biggest deals in Pakistan in the last ten years, Chinese state-backed Shanghai Electric Power Co (SEP) agreed, subject to various conditions, to acquire 66.4% in Pakistani utility K-Electric, from Dubai-based PE house Abraaj Group for USD1.77bn. The deal will give SEP access to 2.5 million customers in Pakistan's biggest city. SEP was chosen from amongst several Chinese bidders who expressed interest in the target.

Attijariwafa bank, a leading Moroccan banking and financial group, agreed to acquire the Egyptian banking business of Barclays Bank. Headquartered in Cairo, Barclays Bank Egypt has 56 branches and 1,500 employees. The transaction, which is subject to regulatory consent and is expected to close by the end of the year, is the first on this scale from a Moroccan financial operator in the Egyptian market.

The sale of a majority stake in Kuwait Food Co (Americana) to Gulf-based investment firm Adeptio, a consortium led by prominent Dubai businessman Mohammed Alabbar, for USD2.35bn, was completed this quarter, through a mandatory offer process on the Kuwait stock exchange. Americana, which owns franchises such as KFC, The Counter and Pizza Hut, has more than 1,690 outlets and employs around 63,000 workers in the MENA region.

As part of its strategy to invest in infrastructure with a steady earnings stream, the Abu Dhabi Investment Authority (ADIA) agreed to acquire a 16.7% stake in Scotia Gas Networks (SGN) from SSE, the second-largest energy supplier in the UK. In an all cash deal, subsidiaries of the Abu Dhabi sovereign wealth fund will pay approximately GBP621m for SGN, with SSE retaining a 33.3% share. ADIA aims to invest between 1 and 5% of its portfolio in infrastructure. SGN manages GBP5bn-worth of assets and had a turnover of GBP1.1bn in the year ending March 2016.

> "Caution prevails, as the background of global *uncertainty* and slowdown leads to funds being utilised more strategically."

SUB-SAHARAN AFRICA

Outbound investment dominates

The slowdown in economic growth and continuing political uncertainty across the region has depressed investment into and within Africa for most of 2016 and has forced investors in key markets, notably South Africa, to search overseas for stability and growth.

With the IMF forecasting minimal growth for the region in 2016 and only a modest recovery in 2017, that's a picture we expect to persist in the year ahead, with inbound investors assessing any potential acquisitions with great caution and outbound investors continuing to scout for deals in other markets, particularly Europe.

Q4 saw several significant transactions by South African investors overseas, not least the up to GBP800m acquisition of the UK diagnostic business, Alliance Medical, by Johannesburg-based private hospital operator, Life Healthcare.

The deal follows similar South African investments in the UK health sector by both Mediclinic International and Netcare and will transform Life Healthcare's earnings profile. Following earlier deals in India and Poland, the group has now seen the proportion of its overseas earnings rise from 4% to 24% following the latest transaction.

Famous Brands has also been on the UK acquisitions trail, buying the Gourmet Burger Kitchen business for GBP110m to bolster its portfolio of fast food brands that already includes Wimpy, Steers and Debonairs.

South Africa and Nigeria remain gripped by economic and political uncertainty and their economies are both depressed

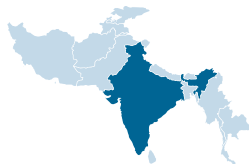
While the latest deal is clearly strategic it proved opportunistic too, completing at a much keener price than expected thanks to the devaluation of sterling following the Brexit vote. More generally, though, the turbulence caused by the UK referendum does not seem to be dampening the natural affinity South African investors feel for the UK, although it might in future deter investors looking to use the UK as a bridgehead for expansion across the EU.

In another significant fourth quarter deal, the South African internet and media group Naspers successfully disposed of Grupa Allegro, its Polish-based online auction business, for USD3.25bn to funds advised by Cinven, Permira and Mid Europa Partners.

We are still seeing some investment activity within key African markets, although both South Africa and Nigeria remain gripped by economic and political uncertainty and their economies are both depressed. Activity in more stable east African states, like Kenya, is a little more robust, but only marginally. Nevertheless, intra-regional investments are occurring.

Liberty Holdings of South Africa, for instance, completed two insurance transactions in Q4, acquiring Prefsure in Botswana and Charter Insurance in Malawi. As the King of Morocco stepped up efforts to build economic and political ties with a tour of East African countries in October, Moroccan investors continue to target deals across the region and we expect to see a number of transactions come to fruition in early 2017.

Efforts by Barclays to withdraw from key overseas markets to focus on its UK and U.S. interests are proceeding with mixed success. Q4 saw it successfully dispose of its Egyptian interests to the Moroccan bank, Attijariwafa. But efforts to sell its continuing interest in Barclays Africa Group are moving more slowly than expected.



INDIA

Short-term disruption expected

The surprise crack down by the Indian Government on corruption and illegal "black money" holdings has had an immediate and dramatic effect on ordinary citizens but it is too early to predict its wider economic impact.

In the medium-term, the snap decision to remove 500 and 1,000 rupee notes from circulation looks a sensible, if totally unexpected, way to tackle corruption and tax avoidance and could even help to bring down inflation.

But it would not be surprising if consumer spending and M&A activity were both affected over the next quarter, at a time when the transaction market has been showing signs of strong growth with a record USD58bn worth of deals announced in the year to date.

Sectors most likely to be hit in terms of transactions are real estate and infrastructure, although these were both active in recent months. Canadian asset management fund Brookfield has, for instance, invested USD1.6bn to buy a 51% stake in the telecoms towers business of Reliance Communications and bought 5m sq ft of office and retail space from Hiranandani Developers for USD1bn.

"*Inbound* investment continues to show signs of growth in key areas."

Despite the short-term disruption caused by the black money corruption initiative, Narendra Modi's Government continues to introduce economic reforms to stimulate growth and investments at all levels of the economy.

These include steps to reduce capitalisation requirements for inbound investors in financial services. During 2016, a growing number of measures have also been unveiled to support new high growth businesses under the Government's flagship 'Startup India' programme. These include moves to make it easier for new businesses to raise money from foreign venture capital funds and a relaxation of the rules on sweat equity shares and employee stock options to help new businesses retain valuable employees.

Narendra Modi's Government continues to introduce economic reforms to stimulate growth and investments at all levels of the economy

Given these and other moves, we expect the wider economy and the M&A market to return to recent strong levels of activity as 2017 progresses.

Sectors proving most lively at the moment include fintech, healthcare and renewables, where Tata Power Renewable Energy, a subsidiary of Tata Power, is building a formidable solar and wind business following its acquisition of Welspun's renewable assets, a deal completed in September. With a total of 2,300 MW of assets, it is now India's biggest renewable operator.

In the financial services sector, the two main preoccupations are consolidation and finding new ways to deal with a mountain of bad loans held by India's banks.

The merger of State Bank of India with the State Banks of Mysore, Travancore, Bikaner and Jaipur, Hyderabad, and Patiala as well as the new Bharatiya Mahila Bank, continues apace, and is the biggest banking transaction ever undertaken in India. It will create a global top 50 institution, with over USD450bn of assets, 24,000 branches and 270,000 employees.

Meanwhile, efforts to clear the banking sector's stockpile of non-performing and distressed loans to industry are continuing with a number of specialist funds being set up to invest in distressed assets. A new bankruptcy law, in respect of insolvency and liquidation of (defaulting) corporate debtors, has been recently notified with effect from 1 December 2016. This law has only been partially notified and provisions relating to voluntary winding up are yet to be brought into force.

In the wider market, PE funds continue to be most active on the sell side, while strategic investors continue to dominate the scene in terms of acquisitions. Inbound investment continues to show signs of growth in key areas, not least energy, where Russian oil giant Rosneft has led a consortium of investors to buy refinery and port facilities from Essar Group for USD13bn.

With Indian companies continuing to focus most on domestic consolidation, outbound investment remains at a relatively low ebb. But there are some signs of life as we saw with ONGC's acquisition of an 11% stake in the Rosneft subsidiary, Vankorneft, and Wipro's USD500m acquisition of the U.S. software group, Appirio. We believe we will see growth in outbound deals eventually, but it could take some time.

“Market and currency volatility indicates just how hard investors are finding it to judge the likely *implications* of U.S. election results.”

LATIN AMERICA

Growth in very uncertain times

After a period of political and economic uncertainty, we have seen a strong surge in the number of cross-border transactions across the region, with a particular focus on energy, infrastructure and utility assets.

With a solid pipeline of significant cross-border deals in the offing, this recovery in the transactions market should continue in 2017 bringing to an end a prolonged period of inactivity. But much will depend on both domestic political and economic conditions and – as importantly, given the region’s close dependency on the U.S. – the impact of a Trump presidency.

A number of key markets continue to wade through choppy political waters and none more so than Brazil. Michel Temer, the new President whose administration has already faced corruption allegations, is trying to force through tax, social security and financial reforms and these will determine not only the fortunes of his administration but also how far and how fast the country emerges from the grips of recession.

New or relatively new governments in Peru and Argentina have got off to favourable starts, but it is early days and investors are still looking for proof that more investor-friendly policies will be sustained.

The direction of U.S. economic policy will be as crucial in these markets as in Chile and, most importantly, Mexico, the latter seeing its currency plunge to record lows in the immediate aftermath of the Trump election thanks to his anti-Mexican rhetoric and his threat to renegotiate the North American Free Trade Agreement.

All eyes are on U.S. interest rate policy. Mexico had been looking to raise its own rates to try to keep a closer track on U.S. rates and other countries are looking to follow a similar path. Brazil, saddled with very high interest rates, faces an opposite dilemma and it remains to be seen if plans to reduce rates will now be delayed or if its pace will just be adjusted.

Market and currency volatility perhaps indicate just how hard investors are finding it to judge the likely implications of election results. There’s some excitement, but also caution. That has a direct impact on the transactional market, not least because cross-border deals in the region are overwhelmingly governed by New York law.

A number of key markets continue to wade through choppy political waters

One of the standout deals of Q4 was the acquisition of Odebrecht Ambiental, the water and sewage company of the Odebrecht Group, by the Canadian investment fund Brookfield which is increasingly active in the market having just acquired a gas distribution network from Petrobas, among others. The latest deal could eventually be worth approximately USD1.2bn.

We will see more significant disposals by companies caught up in Brazil’s long running ‘Car Wash’ corruption scandal, many of which are being forced to retrench and to sell off assets to pay down debt and increase liquidity.

Meanwhile, Duke Energy’s decision to quit Latin America to focus on stable regulated markets, has seen it sell off its Brazilian power interests to China Three Gorges and businesses in Peru, Chile, Ecuador, Guatemala, El Salvador and Argentina to the New York-based PE fund, I Squared Capital.

The toll roads sector also continues to be an active market for infrastructure deals as we saw with the Abu Dhabi Investment Authority’s decision to acquire a 20% stake in Abertis Autopistas Chile.

Sectors

Insights, **Q4 2016**

Sector insights

Not surprisingly, sectors that powered the M&A market to record levels in 2015, not least life sciences and TMT, have fallen back heavily in a more turbulent economic and political environment. Yet big strategic transactions are still getting done and this is likely to continue.

PRIVATE EQUITY

Consortium deals on the rise

Private equity transactions continue to run at pretty consistent rates, and we are seeing a strong pipeline of deals that should be completed before the end of the year.

Of course, pipelines come and go and sometimes for quite unpredictable reasons, but there is no evidence that wider political uncertainties are yet blunting the appetite of PE funds to do deals.

As funds continue to weigh up a range of geopolitical issues, Brexit and the election of Donald Trump are obviously to the fore right now. But the general view seems to be that the impact of both will take time to feed through. Where Brexit is concerned, the growing consensus is that it will be the second half of next year before the real economic effect is felt in rising UK inflation, higher interest rates and reduced consumer spending.

> PE funds have a knack of turning adversity into opportunity and an economic slowdown may not automatically curtail deal activity

That could dampen the transactions market, as M&A tends to thrive at times of economic growth and stability. But PE funds have a knack of turning adversity into opportunity and an economic slowdown may not automatically curtail deal activity.

The age and profile of some of the larger portfolios means, for instance, that we are likely to see a new wave of exits in 2017. And with a number of leading PE houses – including Permira, Apax and Carlyle – successfully raising billions of dollars of new funding at the top end of expectations, funds are sitting on plenty of fresh cash and still enjoying good access to debt financing which doubles their fire power. This is all money that will have to be invested.

One trend that has grown throughout 2016 and which we expect to continue is the growth of consortium deals, with PE houses teaming up with longer-term investors, such as pension funds, with strategic buyers or with fellow PE players to take on bigger acquisitions.

The advantage of teaming with a strategic buyer is that it can bring useful industry expertise and context to the table, and can justify the bidders paying a higher price in the auction process because of the greater synergy savings the strategic partner may be able to unlock.

Canadian and U.S. pension funds are showing much greater willingness to partner with PE funds and this is increasingly driving deal activity. Bringing two financial investors together with different return requirements and timelines not only increases the financial resources available but also offers an alternative exit option with one of the partners possibly acting as a captive buyer should the other want to cash out. Finally, the sheer size of some deals means that sponsors are needing to team up in order to be able to finance the equity cheque.

The USD3.25bn sale of Grupa Allegro, the Polish-based online auction site, in Q4 was a prime example of PE funds joining forces to mount an ambitious buy out. In this case the business was sold to funds advised by Cinven, Permira and Mid Europa Partners in a deal that we believe could be a pre-cursor to consolidation in the lucrative but increasingly crowded online auction market.

Another standout transaction was Carlyle Group's USD3.2bn acquisition of Atotech, Total's speciality chemicals business, a transaction reported to have attracted intense competition from rival PE funds.

Secondary buyouts continue to grow at a faster rate than proprietary deals, as they have done for most of the last two years. But we are also seeing a growing number of successful 'buy and build' transactions, where a fund might acquire a strategic target and combine it with a complementary business bought in a secondary deal from another fund.

CONSUMER

A quiet descends

After a raft of strategic mega deals in the consumer sector over the last 18 months, the value of transactions in this area started to decline as the final quarter of 2016 arrived.

This reflects a number of factors, not least that a pause in deal making was always likely after the busy activity of 2015, as investors now seek to consolidate and capitalise on the acquisitions they have made.

Political and economic uncertainties have also played a role and more so than in other sectors, because of the direct consequential effect that volatility can have on consumer confidence – although in some markets, notably the UK, consumer spending seems to be holding up better than expected.

In contrast to the decline in transactional value, we are, as we have predicted in the past, seeing a steady volume of deals, buoyed up by smaller transactions in key markets.

China has been notably busy in this respect in Q4 with a significant number of consolidation deals between players seeking to strengthen their appeal, reach an expanding middle class and tap into a corresponding surge in consumer spending.

The U.S. also saw some good growth at the start of the quarter, a feature common across a number of sectors. However we would not be surprised to see a slow down of activity over the winter, not least as investors try to get a handle on what a Trump presidency might mean for the wider economy and U.S. tax and interest rate policies.

Notwithstanding the above, there have been a small number of large strategic deals still happening with the standout transaction in Q4 possibly being the offer by British American Tobacco plc ("BAT") for the remaining 57.8% stake of Reynolds American Inc., for an initial USD47bn. If ultimately successful, this will continue a trend of consolidation in the tobacco industry, with assets being concentrated into the hands of an increasingly small number of big players.

The deal would also complete a tie up that began in 2004 and follow Reynolds' successful acquisition of Lorillard in 2015, a transaction which saw BAT make an equity injection of GBP4.7bn in Reynolds in order to maintain its existing 42.2% stake.

Due to antitrust rulings, we are also seeing significant divestments notably AB InBev's sale of its east European beer brands following its tie up with SABMiller.

Equally e-commerce remains an active sector in a number of markets and one of the significant consumer deals of Q4 was the sale by South African media group, Naspers, of Grupa Allegro, its Polish online auction site for USD3.25bn to funds advised by private equity firms Permira, Cinven and Mid Europa.

> Surprisingly, at times of political and economic uncertainty we often see a spike in activity at the top end of the consumer market

For multinationals in the sector hoping to build a presence in the Chinese market, e-commerce is increasingly being seen as a useful entry point and we expect to see growing activity here too. Online travel businesses are also emerging as a hot spot between India and China as we saw with the acquisition by FCM Travel Solutions, the Indian arm of the Australia-headquartered Flight Centre Travel Group, of the south India-based travel company Travel Tours Group.

Perhaps surprisingly, at times of political and economic uncertainty we often see a spike in activity at the top end of the consumer market, in part due to due to greater consumer resilience, and that is proving the case right now. For instance, the final quarter of 2016 has seen LVMH agree to pay EUR640m for an 80% stake in the German luxury luggage maker, Rimowa, and Constellation Brands agree to acquire Obregon Brewery from Grupo Modelo for USD600m, having acquired its U.S. beer business back in 2013.

ENERGY AND INFRASTRUCTURE

Big deals lift a troubled market

On the face of it, as 2016 draws to a close, the energy and infrastructure sector looks to be one of the most resilient, showing rare signs of growth in terms of deal values.

But the figures, flattered by a number of big transactions, belies a more troubled picture as the energy industry continues to struggle against a backdrop of still relatively soft oil prices with every likelihood that they will remain at the current depressed level for some time.

The growth we are seeing also comes from a low base – 2015 was a notably quiet time for deal making in the sector.

Recent months have seen some big deals, however, including the merger of GE's oil and gas business with Baker Hughes. The deal represents a swift bounce back for Baker Hughes after its proposed merger with Halliburton was blocked earlier in the year and marks GE's continued effort to focus on its core engineering businesses.

> With oil prices remaining in the USD50 to USD60 a barrel range, the impetus for doing major transactions remains relatively weak and we expect that situation to continue

Closer energy ties between Russia and India have been a growing theme in 2016, with Indian oil and gas companies investing in Russia and now investment flowing the other way too. October saw a Rosneft-led consortium, including commodity trader Trafigura, pay USD13bn to take control of oil refining and port assets from India's Essar Group, while ONGC also agreed to acquire an 11% stake in Vankorneft for USD930m.

Another ongoing theme of the year has been a growing number of mid-size transactions, often involving the swapping of individual or groups of assets between oil and gas companies as they look to refocus their portfolios.

But with oil prices remaining in the USD50 to USD60 a barrel range, the impetus for doing major transactions remains relatively weak and we expect that situation to continue. One conundrum is the ease with which some supplies – notably U.S. shale – can be turned on and off as the price fluctuates. Any firming of the price will usually provoke producers to switch supplies back on, tending to immediately keep the price in check.

Energy infrastructure – like the rest of the infrastructure sector – continues to be decidedly more buoyant, driven by huge demand for relatively scarce assets. One of the largest deals of the quarter was the sale of 50.4% of Ausgrid to two powerful Australian pension funds, following the blocking of an earlier proposed sale to Chinese investors on national security grounds.

> Closer energy ties between Russia and India have been a growing theme in 2016

Renewable energy is also a hot sector, with offshore wind power becoming increasingly active. This is thanks to significant advances in battery technology that now look to other effective ways to store intermittent wind power, up to now the Achilles heel of this technology.

Such advances are leading to some interesting strategic moves by big players as they rebalance their interests towards renewable energy.

In September, E.ON spun off its oil, gas, coal and energy trading interests into a new company called Uniper to focus exclusively on renewables, while German rival RWE floated its Innogy business, largely focused on renewables, in the largest European IPO since 2011. Denmark's DONG Energy has led the way by investing the income from its oil and gas interests into offshore wind at home and in the UK.

Elsewhere in the infrastructure sector, there remains a lot of capital chasing relatively few assets. Institutional investors continue to increase allocations to the sector, attracted by the perceived long-term and stable cash flows as an alternative to low yielding government and corporate bonds.

However, commentators have noted the uneven playing field created for European insurers wishing to invest in the sector by higher capital requirements under the EU's Solvency II regulation. This, they argue, is making long-term investment more expensive for European players compared with financial players in less regulated markets.

"In Asia the *pipeline* of financial services deals remains relatively strong, even if deals are somewhat smaller."

Meanwhile, the UK market is waiting to see how commitments in the Autumn Statement, to increase infrastructure in a bid to improve productivity, will translate into private sector opportunities. Commitments include investment in local transport networks and strategic roads, with more detailed proposals for rail projects over the coming weeks. The UK Government has also confirmed plans for GBP16bn investment in digital infrastructure.

The Trump phenomenon is also making its presence felt in the U.S. infrastructure market, as early indications of increased federal infrastructure spending and privatisations sets the scene for deal activity in coming years.

FINANCIAL SERVICES

Adjusting to the new politics

For most of 2016, politics has been the overriding pre-occupation for the financial services sector, particularly in Europe, and it looks likely to continue dictating events for some time to come.

This has inevitably put a significant dampener on transactions in the sector which have been at a low ebb for most of 2016. Why would any institution attempt a major strategic deal at a time of such enormous political uncertainty?

Certainly that remains the case for any of the big trophy banks that have spent the last 40 years building a formidable presence in London. They are now planning their response to Brexit, deciding how much of their business they will need to relocate to alternative centres in the EU27, to preserve their access to the EU single market.

We would expect to hear what those plans entail in early 2017, with most commentators speculating that banks with regulated entities already established in another EU27 financial centre and needing to relocate operations or recourses, are likely to favour moving them to centres where infrastructure and regulatory approvals are already in place.

Though the UK Government seems keen to preserve single market access for financial services firms, this could prove extremely difficult. In something of a reverse auction process, competition to attract these banks to Dublin, Frankfurt, Luxembourg, Brussels, Madrid and Paris is already intense, with other centres also promoting their newfound love of bankers. Meanwhile, the other EU27 states are likely to drive a hard bargain on market access, which could make it very tricky to agree a transitional arrangement to smooth the expected migration.

For that reason most banks are planning for a "hard" Brexit within the two-year period prescribed by Article 50 and we would expect them to start taking concrete decisions on their relocation plans early in the new year.

Though the UK Government seems keen to preserve single market access for financial services firms, this could prove extremely difficult

Similar moves are being (more quietly) planned by some of the big insurers, though the impact on different types of insurers is likely to vary. For example, life insurers tend not to conduct as much cross-border business as non-life businesses. Additionally, the largest life insurers generally already have independently capitalised European subsidiaries already. When it comes to asset managers and asset servicing activities, Luxembourg is seen as an attractive centre for operations.

The question, in all the above cases, is how much of their operations will financial institutions move and what sorts of capital requirements will they have to meet in their new chosen locations?

Donald Trump's election victory poses another set of difficult questions for the sector, given that his campaign was very light on policy detail, despite being built on a clear low tax, deregulation agenda.

There have been hints that he might want to unwind the Dodd-Frank banking reforms introduced after the Lehman's collapse, but also suggestions he might hobble Wall Street's biggest institutions in favour of supporting smaller local banks, perhaps forcing the global banks to ring-fence their retail operations from their investment banking arms.

How that policy circle will be squared and by when will not begin to become clear until his chosen Treasury Secretary takes up post and, with so much uncertainty about, it's hardly an auspicious time for deal making.

Despite these factors depressing activity, Q4 has seen a few sizeable regional and cross-border deals, the largest focusing on insurance and asset management. Dutch insurer NN Group has offered EUR2.4bn to buy its local rival Delta Lloyd, Japan's Sompo has agreed to acquire the Bermuda-based U.S. insurer, Endurance Speciality Holdings, for USD6.3bn and UK asset manager Henderson has offered USD2.6bn to take control of Janus Capital of the U.S.

We continue to see some divergence in trends between Asia and the rest of the world. The pipeline of financial services deals remains relatively strong in Asia, even if deals are somewhat smaller, particularly as western strategic investors continue to retreat from what they see as non-core markets to focus on their core operations and regional investors look to pick up good assets at competitive prices.

DBS, for instance, has agreed to buy the wealth management business of ANZ in Singapore, Hong Kong, China, Taiwan and Indonesia, having bought the Asian wealth business of Société Générale in 2014. Some believe this latest deal is somewhat of a pre-cursor to an even bigger regional transaction between the two groups, as ANZ retreats and the Singapore bank seeks to build an APAC-wide presence.

LIFE SCIENCES

A sigh of relief?

There was little prospect that the record level of life sciences transactions in 2014 and 2015 would be matched this year, but the reduction in the value and volume of deals has probably been greater than expected.

One reason for the recent sluggish activity was the impact of the U.S. presidential election where the expectation was that Hillary Clinton – for years a firm advocate of cracking down on the pricing policies pursued by leading pharma companies – would triumph. While Trump's election success saw markets briefly relax at the thought that he might take a less interventionist approach to regulation of drug pricing, uncertainty returned after Trump announced that he too would look to cut drug charges.

He has also been somewhat inconsistent in his approach to reforming Obamacare. Originally he threatened to replace this on day one of his presidency, but he has now made it clear he will preserve elements of it such as the right of children to be on their parents' insurance policies and the stipulation that no-one can be refused cover.

Where Trump may still provide a boost to the life sciences sector is if he stays with his commitment to cut corporation tax from 35% to 15%. This move might encourage big U.S. players to repatriate the large amounts of offshore cash they currently hold.

The election of Donald Trump is being seen as a positive for the sector

One thing that would seemingly have zero chance of making a return under a Trump administration is the sort of tax inversion deals that fuelled so much transaction activity in the sector over the last two years.

Instead we expect to see investors focusing on, and being prepared to pay good premiums for, valuable assets in highly innovative areas, such as bio-electronics.

A number of big deals could be in the pipeline for 2017. Speculation is mounting that Pfizer will abandon plans to split into three, instead opting to hive off its consumer interests, a business expected to be worth between USD15bn and USD20bn. Interest in this, particularly from companies with large consumer healthcare divisions, such as GSK and RB, could be intense.

Such deals, together with ongoing portfolio tidying transactions should, we think, lead to a good amount of activity in the year ahead and that is matched by a sense of cautious optimism in the sector.

Amongst the standout deals of Q4, was the GBP800m acquisition of European diagnostic imaging group, Alliance Medical, by the South African private hospital operator, Life Healthcare. This continues a trend of healthcare groups looking to establish themselves in overseas markets to diversify their earnings.

The move by Abbott Laboratories and St Jude to sell off elements of their vascular and electrophysiology units, worth USD1.2bn, to Terumo of Japan is a "fix it first" remedy to try to secure antitrust clearance for the USD25bn merger of the two medical devices companies. The sale is conditional on the merger completing.

We still expect to see deal activity pick up amongst companies operating in the related fields of gene mapping and new gene therapies. Although there was limited M&A in this segment in the last quarter, we did see the third IPO by a company focused on CRISPR/Cas9 technologies when CRISPR Therapeutics followed the lead set by Editus and Intellia earlier in the year. This latest market debut coincides with news that Chinese researchers have launched the first human trials of CRISPR technology, and, despite ongoing disputes over patents in this area, we believe this is a segment ripe for increased activity in the near future.

MINING

Reasons to be cheerful

It has been many quarters since we were able to report any real shift in momentum for mining transactions but, as 2016 closes, we are detecting some important signs of confidence returning to the sector after two or more years of stagnation.

M&A activity in mining has been becalmed by a combination of factors – namely chronic oversupply of the market at a time of slowing economic growth in key markets especially China, rock-bottom commodity prices and an industry saddled with high levels of debt which almost all of the majors are now addressing with some vigour.

As the year has progressed, all these factors have begun to turn more positive. Take commodity prices, for example, where we've seen prices gradually recovering for both bulk and speciality commodities. Iron ore may still be a long way off its peak of around USD140, but it is well above its USD30 nadir and appears to be holding steady at around USD80.

Some analysts believe this is a temporary position and that volatility will return. But there are some convincing reasons to believe they might be wrong, not least the fact that, after the deep cost-cutting carried out by many of the mining companies, current prices are making their operations highly profitable. In addition, China has closed a great deal of high cost capacity and is now suddenly importing again at much higher than expected levels.

> The industry is in better shape now than for some time and that could see the mining M&A market bubble back into life next year

Demand for high quality coal, for instance from Eastern Australia, is also on the rise, while those who dared to invest in copper during the dog days of the commodities slump are looking a lot cleverer than previously thought. That is encouraging support on the equity capital markets for new exploration activity by smaller mining groups.

Politics plays a part too. Gold – a traditional haven at times of currency volatility and economic uncertainty – is a case unto itself and continues to show strength, prompting consolidation moves within the sector. Some are taking hope that pledges by Donald Trump to prioritise infrastructure spending will increase demand for key commodities. It may be a bit far-fetched but it is at least increasing confidence, a key pre-requisite for M&A activity.

Specialist mining funds are also becoming more active, and, in contrast to earlier in the year, are beginning to return to competitive auction processes, with zinc and copper assets a particular priority.

We are also seeing consolidation moves in the mining services sector with contractors now looking to boost their market position through deals, having also cut their cloth to meet leaner times. That was the main motivation behind the USD527m agreed bid by Hitachi Construction, maker of giant excavation equipment, for Bradken, the Australian mining services group.

We would not expect to see a huge uptick in activity in 2017, but the industry is in better shape now than for some time and that could see the mining M&A market bubble back into life next year.

“We are in a period of *adjustment* with companies trying to work out the new lie of the land.”

TELECOMS, MEDIA AND TECHNOLOGY

Testing the ground

As a test of the new U.S. political environment following Donald Trump’s election victory, the giant USD85bn proposed merger between AT&T and Time Warner is an effective one.

This is a deal that the President-elect said he would work to block as soon as it was announced, arguing that it represented a dangerous concentration of media power. His election saw the AT&T share price slump with most commentators predicting the deal would be hard-pressed to pass through the normal antitrust hurdles, let alone Donald Trump’s overt opposition.

Yet in the process of transitioning into office, the signals have changed slightly and some commentators are now expressing confidence that the deal will complete.

It’s an example of how TMT companies are adjusting to the changing political environment. Some market commentators suggest that Trump lacks Obama’s enthusiasm for innovation and that his stance on immigration runs counter to Silicon Valley’s dependence on being able to hire talent from across the world. This has led some to conclude that his election is particularly inauspicious for the TMT sector in general, and the tech sector in particular.

> We are also seeing brisk pick up in activity around innovative online payment or ‘digital wallet’ systems

In reality we are in a period of adjustment with companies trying to work out the new lie of the land. In the short term, this could have an effect on deal activity but it is likely to be relatively short-lived and, as in other sectors, Trump’s outline plans to cut corporation tax rates from 35% to 15% could well tempt U.S. tech companies to bring cash back onshore.

Ahead of the announcement of the Time Warner deal, there had been speculation that AT&T might make a tilt for either Vodafone or Telefonica but that now looks to be off the table and we are unlikely to see any activity by U.S. telecom companies in Europe in the near future.

Meanwhile, some do see scope for further consolidation between fixed line and mobile operators in Europe, bringing cable and wireless players together. And with valuations rising again, we could also see activity in the Metro Networks sector where operators like Colt are now trading at much higher multiples.

We are also seeing brisk pick up in activity around innovative online payment or ‘digital wallet’ systems. This autumn has seen two relatively small but significant deals in this area, with Alibaba’s finance arm, Ant Financial, buying EyeVerify, a maker of optical recognition technology, and Naspers acquiring the Indian fintech group, Citrus Pay.

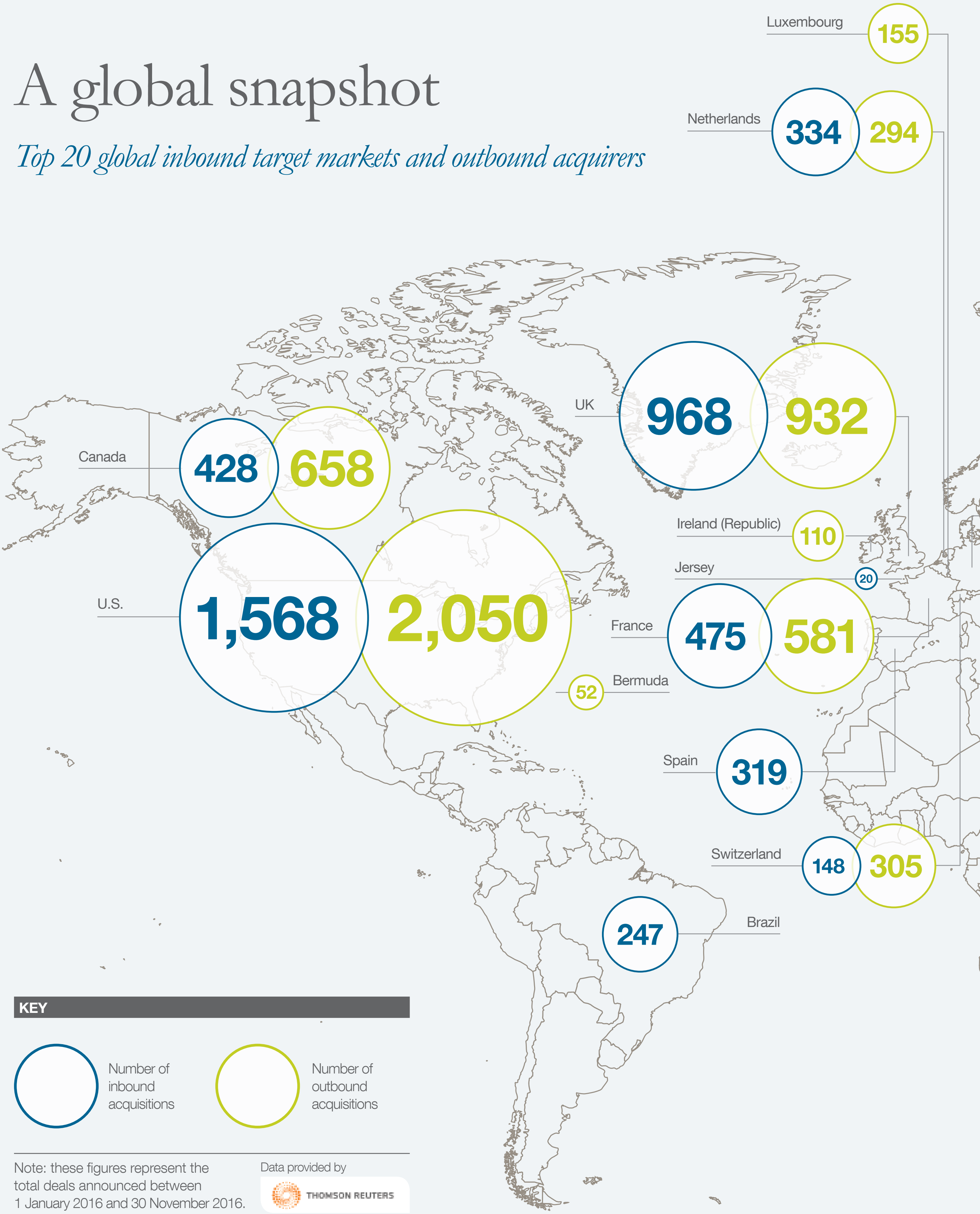
Meanwhile the sale of Edinburgh-based Skyscanner, the online travel business and one of the UK’s few GBP1bn plus Unicorn tech companies, has reignited the debate about the UK’s failure to scale up its brightest growth businesses. The group has been bought by China’s largest online travel company, Ctrip, in a deal valuing Skyscanner at GBP1.4bn.

Somewhat ironically the deal came as UK Chancellor Philip Hammond used his Autumn Statement to say he was specifically addressing this issue. He has promised a GBP400m injection of funds through the British Business Bank to unlock some GBP1bn of venture finance for growing firms – although Skyscanner, which had been destined for IPO, has had no problem raising finance.

A review of the long-term financing issues facing growing businesses is also promised, led by Damon Buffini, former head of the PE fund, Permira.

A global snapshot

Top 20 global inbound target markets and outbound acquirers



KEY

Number of inbound acquisitions

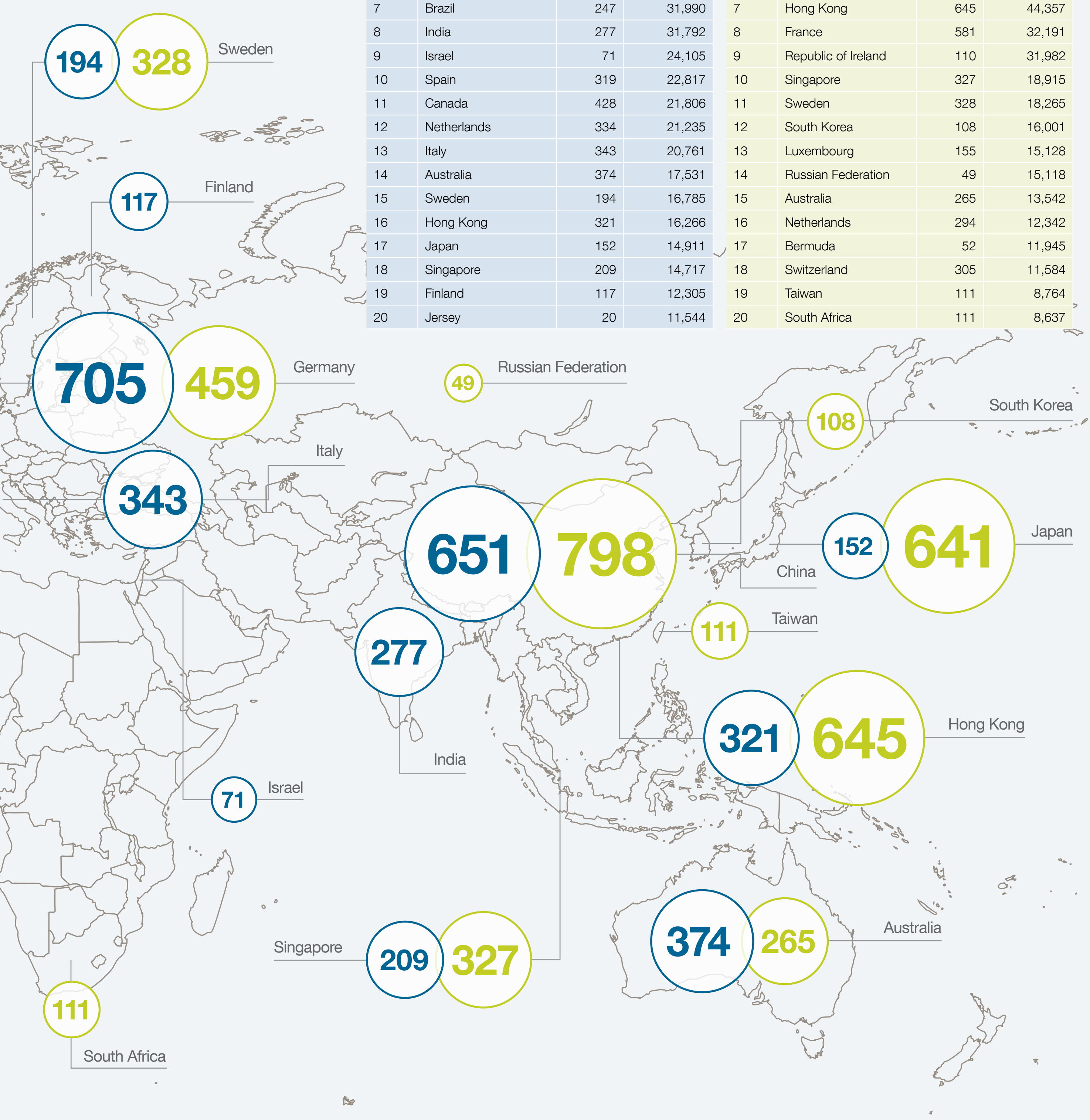
Number of outbound acquisitions

Note: these figures represent the total deals announced between 1 January 2016 and 30 November 2016.

Data provided by THOMSON REUTERS

Top 20 global inbound target markets – 2016 YTD			
Rank	Country	Volume of deals	Value of deals USDm
1	U.S.	1,568	479,099
2	UK	968	103,202
3	Switzerland	148	61,849
4	China	651	39,265
5	France	475	38,856
6	Germany	705	33,421
7	Brazil	247	31,990
8	India	277	31,792
9	Israel	71	24,105
10	Spain	319	22,817
11	Canada	428	21,806
12	Netherlands	334	21,235
13	Italy	343	20,761
14	Australia	374	17,531
15	Sweden	194	16,785
16	Hong Kong	321	16,266
17	Japan	152	14,911
18	Singapore	209	14,717
19	Finland	117	12,305
20	Jersey	20	11,544

Top 20 global outbound acquirers – 2016 YTD			
Rank	Country	Volume of deals	Value of deals USDm
1	China	798	208,588
2	U.S.	2,050	145,507
3	Canada	658	135,379
4	Germany	459	131,900
5	UK	932	111,380
6	Japan	641	75,319
7	Hong Kong	645	44,357
8	France	581	32,191
9	Republic of Ireland	110	31,982
10	Singapore	327	18,915
11	Sweden	328	18,265
12	South Korea	108	16,001
13	Luxembourg	155	15,128
14	Russian Federation	49	15,118
15	Australia	265	13,542
16	Netherlands	294	12,342
17	Bermuda	52	11,945
18	Switzerland	305	11,584
19	Taiwan	111	8,764
20	South Africa	111	8,637



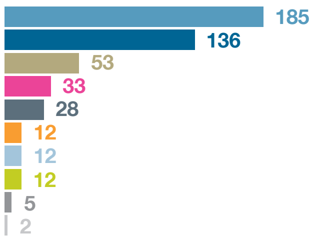
A global snapshot

A global snapshot – top markets for the world's largest acquiring countries

China

Value of deals (USDm)

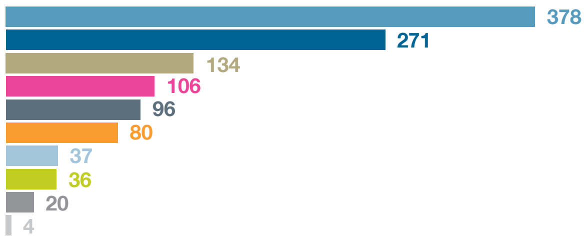
Hong Kong	10,205	Switzerland	48,634
U.S.	64,969	Brazil	15,114
Germany	10,413	Israel	15,110
Singapore	2,912	Finland	8,955
UK	6,019	Dem Rep of the Congo	2,804



U.S.

Value of deals (USDm)

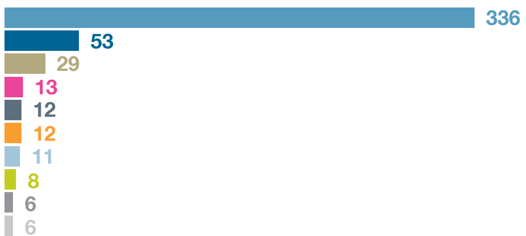
UK	27,480	Spain	5,912
Canada	13,701	Japan	6,403
Germany	7,708	Sweden	13,691
France	11,104	Singapore	5,175
Australia	5,784	Jersey	9,331



Canada

Value of deals (USDm)

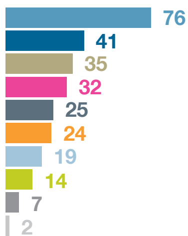
U.S.	109,915	Mexico	1,316
UK	2,894	Brazil	5,408
Australia	645	Ireland (Rep)	423
Colombia	3,184	Switzerland	3,659
India	3,537	Spain	1,685



Germany

Value of deals (USDm)

U.S.	83,003	Austria	4,349
France	12,808	Switzerland	883
UK	15,212	Sweden	1,214
Netherlands	1,459	Luxembourg	2,100
Spain	7,204	Morocco	899

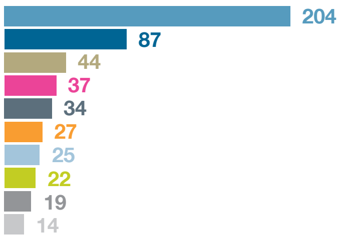


*These figures represent the total deals announced between 1 January 2016 and 30 November 2016.

UK

Value of deals (USDm)

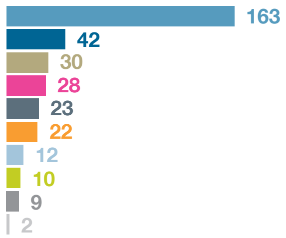
U.S.	81,128	Australia	1,113
France	1,508	Denmark	1,255
Italy	3,115	Canada	1,883
Netherlands	7,803	Norway	977
Spain	1,259	Poland	4,102



Japan

Value of deals (USDm)

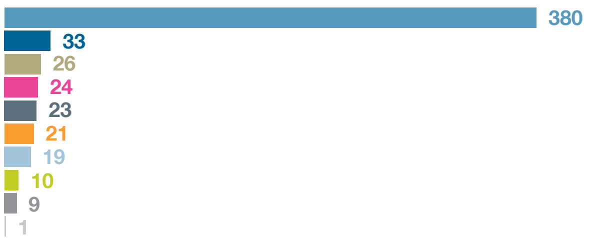
U.S.	21,298	India	753
UK	31,564	Italy	3,128
France	2,039	Philippines	1,008
Germany	2,313	Netherlands	1,179
Australia	1,130	Bermuda	6,301



Hong Kong

Value of deals (USDm)

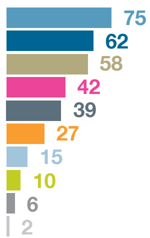
China	25,978	Singapore	635
U.S.	8,725	Japan	253
South Korea	1,315	Canada	1,268
UK	1,368	Germany	251
Australia	1,642	Belgium	1,100



France

Value of deals (USDm)

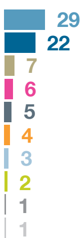
U.S.	17,257	Netherlands	846
Germany	5,224	Switzerland	385
UK	410	Portugal	793
Belgium	391	South Africa	368
Italy	2,561	Peru	1,662



Republic of Ireland

Value of deals (USDm)

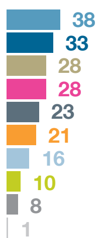
UK	577	Italy	21
U.S.	30,037	Japan	349
Canada	166	Brazil	203
France	264	Switzerland	287
Germany	24	Denmark	45



Singapore

Value of deals (USDm)

China	4,266	Australia	1,445
India	1,395	U.S.	2,663
Indonesia	864	South Korea	710
Malaysia	377	Thailand	1,620
UK	788	Czech Republic	2,662



About the research

The underlying data for this research comes from Thomson Reuters.

– The data contained in this publication spans 1 January 2016 and 30 November 2016 inclusive.

Data provided by THOMSON REUTERS

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