Baker & McKenzie

MERGERMARKET

CROSS BORDER M&A INDEX

Q3 2016

CONTENTS

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Q3 2016: IN NUMBERS

Q3 2016 TOTAL CROSS-BORDER DEALS

1,275 deals
VOLUME

22% ON Q3 2015

Q3 2016 TOTAL CROSS-BORDER DEALS

$373bn
VALUE (US$)

5% ON Q3 2015

Q3 2016 MOST ACTIVE SECTORS (CROSS-BORDER DEALS)

BY VOLUME

INDUSTRIALS

196 deals
(WORTH US$29.1bn)

BY VALUE

CHEMICALS AND MATERIALS

US$77bn
(50 DEALS)

CROSS-REGION

$264bn
VALUE (US$)

17% ON Q3 2015

WITHIN-REGION

$109bn
VALUE (US$)

58% ON Q3 2015

CROSS-REGION

775 deals
VOLUME

19% ON Q3 2015

WITHIN-REGION

500 deals
VOLUME

27% ON Q3 2015

1 CROSS-BORDER M&A INDEX

While political and macroeconomic uncertainty put a dampener on M&A volume in Q3, it hasn't prevented deal value from rocketing quarter-on-quarter.

Large multinational strategic buyers are maintaining a growth rationale that favors acquisitions, pushing up cross-border valuations. As a consequence, Baker & McKenzie's Cross-Border M&A Index, which tracks quarterly deal activity using a baseline score of 100, climbed to 238, up 23% from Q2's total of 194. And, while Q3 2016 is 10% down on the total for the same period in 2015, it is above any quarter between 2009 and 2013.

Buyers announced 1,275 cross-border deals worth US$373bn, a 15% drop in volume but a 64% surge in value compared with the previous quarter. Cross-regional deals saw the greatest increase in value (82%) while intra-regional value had a still substantial 32% rise.

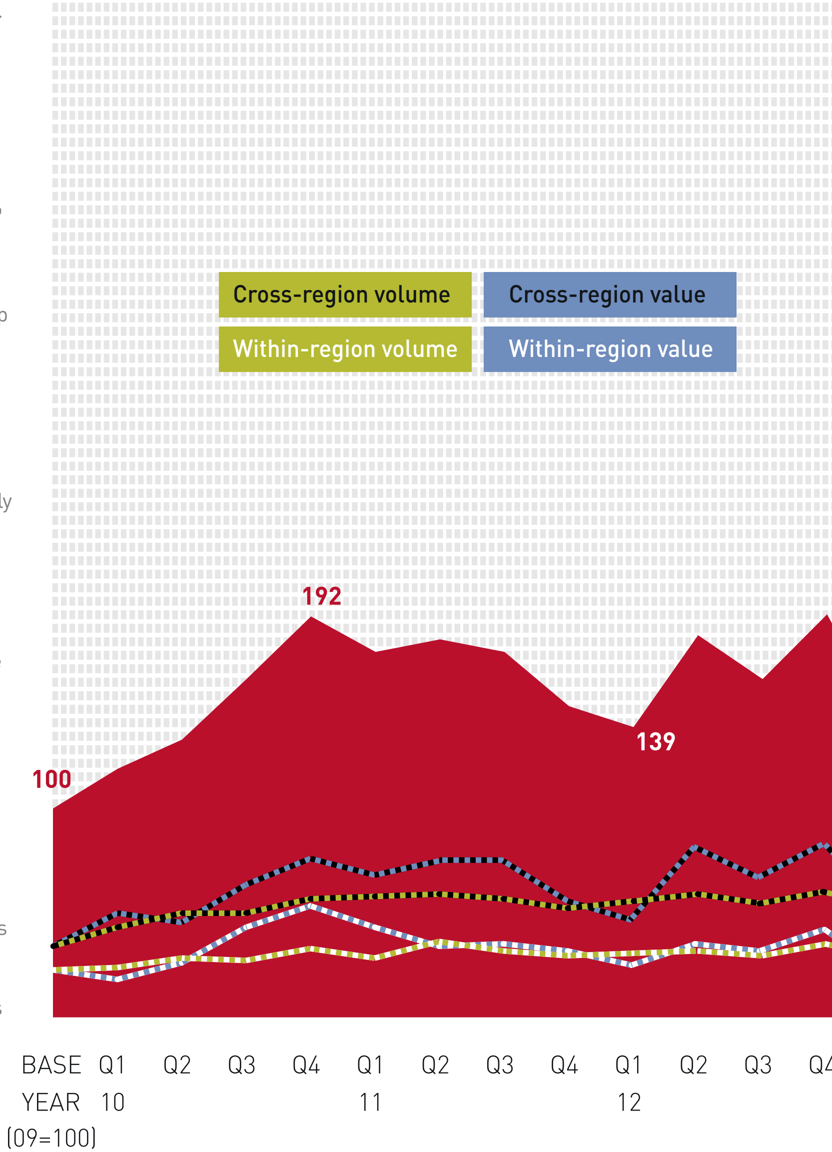
The drop in volume can be attributed to tightening US monetary policy, along with uncertainty caused by the Brexit vote and the US elections. However, in better news for mid-market M&A, global volumes traditionally drop around US elections but then pick up once there is more certainty around the direction of US policy.

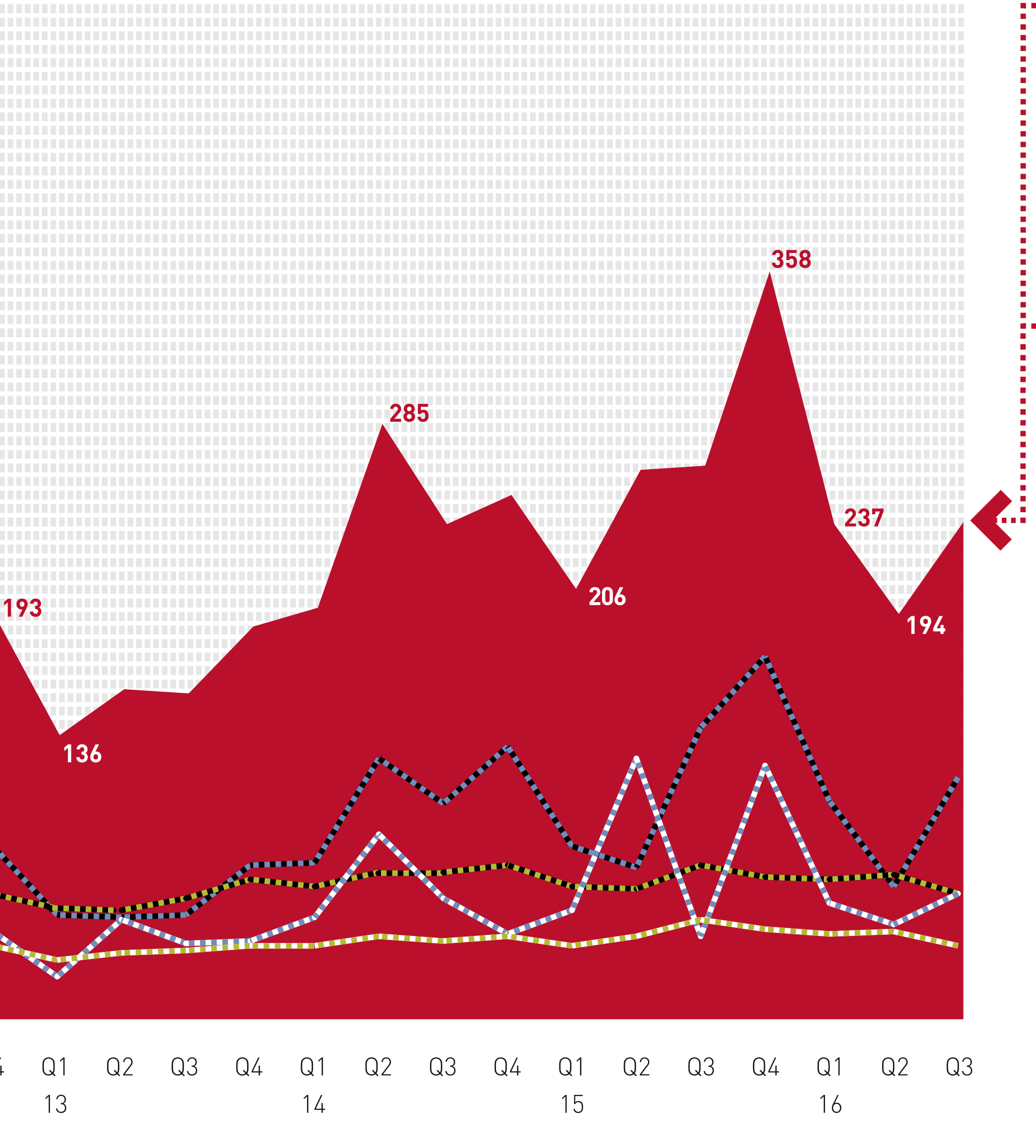
The increase in value has been driven by renewed confidence at the upper end of the market with several blockbuster deals being announced. While deals above US$1bn were 25% down on the same period in 2015, they were still a regular occurrence – particularly inbound into the US.

For example, the biggest deal of the quarter was German chemical giant Bayer AG's US$65bn acquisition of US-based agrochemicals company Monsanto in September. The wave of large deals into the US also included Canada's Enbridge agreeing to buy Spectra Energy for US$41bn and France's Danone acquiring The WhiteWave Foods Company for US$12bn.

On the sector side, chemicals and materials, energy and utilities and technology were the drivers for most of the high value M&A, with deal totals of US$77bn, US$73bn and US$60bn respectively. In technology, the standout cross-border deal saw Japan's SoftBank Group pay US$30bn for UK semiconductor manufacturer ARM Holdings – one of a number of deals that pushed Asian outbound deals into Europe to record levels.

As the dust settles around Brexit and the US presidential election reaches its conclusion, investors, particularly those in the mid-market, will be hopeful of a bounce back in dealmaking volume in Q4 and beyond.





Cross-Border M&A Index Q3 2016

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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.

Data correct as of 1 October 2016

2 THE GLOBAL PICTURE

HEADLINES

1. Cross-border M&A made up 44% of all deal value and 34% of all deal volume in Q3 2016, compared with 41% and 36% for the same period in 2015.

2. Deals from the EU into North America hit record values with US$105bn from 121 deals. This is an increase of 32% on Q3 2015.

3. Asia Pacific buyers carried out 174 cross-regional deals in Q3 worth a total of US$86bn, an increase in value of 30% on Q3 2015 and 67% on last quarter.

The result of the UK referendum sent shockwaves through the EU M&A market in Q3. Cross-regional deal flow into the EU slumped to 271 deals, 30% fewer than Q2 2016 and down 17% on Q1 2016. The result, as well as other geopolitical issues, appears to have spooked a number of regions as volume fell 15% quarter-on-quarter and 22% year-on-year.

Deal values were a different story. Overall, cross-border deal value grew 64% quarter-on-quarter. This is particularly true of EU outbound, which accounted for 44% of all cross-regional M&A value in Q3. Transatlantic deal value in this direction reached a record high, with EU buyers picking up US$105bn in US assets – an increase of 32% year-on-year. This stemmed mainly from Bayer AG's US$65bn acquisition of US-based Monsanto, but Q3 included other large transactions such as UK-based Micro Focus's purchase of Hewlett Packard Enterprise for US$8.8bn.

Overall cross-regional deal value into North America grew by 317% from US$42bn in Q2 to US$133bn in Q3.

The Asian equation

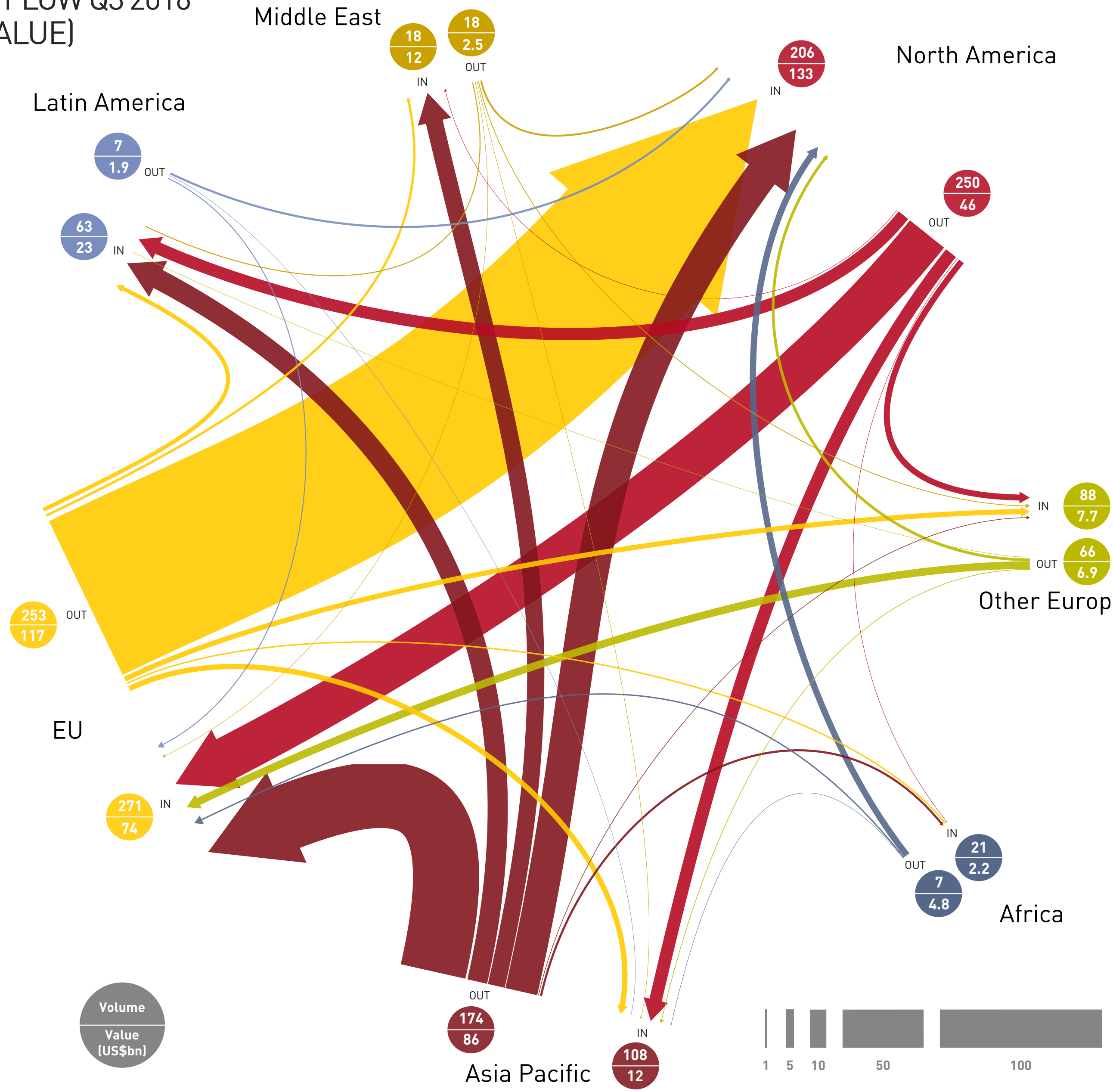
The increase in quarterly deal values was prevalent across most regions – particularly outbound from Asia Pacific, which has already reached record highs – and this buoyancy continued in Q3 with buyers from the region carrying out 174 cross-regional deals worth a combined US$86bn, representing 32% of all cross-regional activity.

Japan was the most active Asian buyer by value, with 69 deals worth a total of US$44bn, sparked in part by negative interest rates and strong corporate balance sheets. Along with major acquisitions in the UK, France and the US, Japan also carried out the largest African acquisition of the quarter and the third largest so far in 2016 with Japan Tobacco buying a 40% stake for US$510m in National Tobacco Enterprise in Ethiopia.

Out of Africa

Cross-regional deals with African buyers hit US$4.8bn, the second largest value from the continent since the Index began. This was driven by activity originating in South Africa, with Steinhoff International Holdings buying US-based Mattress Firm Holding for US$3.9bn, following the purchase of a 76.4% stake in UK discount group Poundland for US$640m. These deals will significantly enhance the African retailer's global footprint and diversify revenue streams as well as serve as a currency hedge for the vulnerable domestic rand. In another similar South African outbound deal, Famous Brands purchased the UK's Gourmet Burger Kitchen for US$158m.

GLOBAL CROSS-REGIONAL DEAL FLOW Q3 2016 (BY VALUE)



3 SECTOR FOCUS: LUXURY

HEADLINES

1 There were 23 luxury cross-border deals in the first nine months of 2016, worth a total of US$3.6bn. The number of deals is already 10% up on 2015.

2 The value of transactions in the first nine months of the year is 21% down on the same period in 2015, but 27% up on that of 2014.

3 Over half of all deals targeted EU-based companies. In the 2015/2016 period to date, the most targeted countries by volume were the UK, the US and Italy. The most targeted country by value was Germany, with three deals worth US$3.3bn.

The luxury goods sector has been something of a rare find in the M&A market in 2016.

In a climate of political and macroeconomic uncertainty in which the deal market has failed to compare to the blockbuster standards of the past two years, luxury cross-border deals have seen a 53% rise in volume in the first nine months of 2016 compared with the same period in 2015.

And despite a 21% drop in value year-on-year, the sector is up 27% compared with the first nine months of 2014.

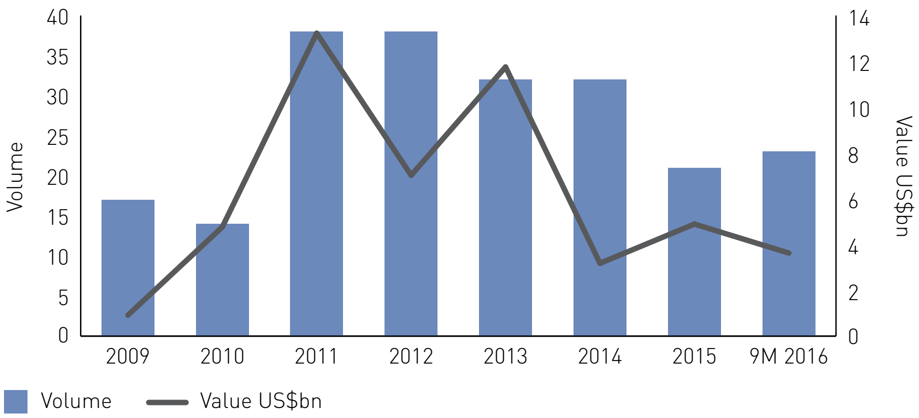
Consolidation as strategy for market growth
"The top 5% of the luxury industry was not as materially affected by the economic downturn as was the rest of the industry," says Marc Levey, a New York-based partner in Baker & McKenzie's international taxation department, and co-chair of the Firm's Luxury & Fashion Industry Group. "And there is a major drive among those big luxury companies to build up or round out their portfolios."

Consolidation has been a key factor in strengthening the luxury M&A market in 2016.

The largest deal of 2016 saw luggage maker Samsonite purchase premium bag maker Tumi for US$1.8bn in March. The deal will give Samsonite the foothold in the luxury market that it previously lacked.

In the same month, US cosmetics company Estée Lauder acquired the French prestige fragrance brand By Kilian for an undisclosed fee. Not only does this consolidate a number of high-end fragrances under the company's umbrella but it also expands Estée Lauder's geographic reach – another contributing factor to the growth in cross-border M&A.

LUXURY CROSS-BORDER M&A 2009–2016



"There are a number of key acquisitions being executed because companies want to grow in certain geographic areas," says Levey. One such deal, despite not being cross-border, was US cosmetics giant Revlon's acquisition of rival Elizabeth Arden for US$870m in June. "Revlon did the deal, presumably, because of its international network. Elizabeth Arden has a tremendous infrastructure there for its brands," says Levey.

Equity and elegance

Buyout firms have also been particularly active in the luxury M&A market in 2016. Three of this year's five highest-value cross-border deals have involved private equity firms including the sale of UK company Signet Jewellers, the world's largest retailer of diamond jewelry, to US firm Leonard Green in August for US$625m.

And according to Paris-based Alyssa Gallot-Auberger, Baker & McKenzie M&A and private equity partner, as well as a Steering Committee member of the firm's Luxury & Fashion Industry Group, the two sectors complement each other perfectly.

"There are a lot of good luxury brands that need capital to fund expansion, for example, which tends to be capital expenditure intensive, and private equity has that capital," she says. "Private equity is also known for successfully building on synergies and making things lean and mean, which is a help to brands looking to expand." And for private equity firms, the association with luxury brands brings a certain cachet.

"There is certainly an appeal to invest in the luxury sector [for private equity], particularly in fashion, because of the immediate brand recognition it provides. It turns a private equity fund into a name overnight thanks to its investment in a well-known brand."

TOP FIVE LUXURY CROSS-BORDER M&A, 2016

Announced Date	Target Company	Target Country	Bidder Company	Bidder Country	Deal Value US$m
03/03/2016	Tumi, Inc.	USA	Samsonite International S.A.	Luxembourg	1,708
25/08/2016	Signet Jewelers Limited	United Kingdom	Leonard Green & Partners LP	USA	625
15/07/2016	Stroili Oro SpA	Italy	THOM Europe SAS	France	333
20/06/2016	Groupe Acrotec SA	Switzerland	Castik Capital S.a.r.l.	Luxembourg	292
18/04/2016	Amor GmbH	Germany	Gilde Buy Out Partners BV	Netherlands	222

However, not all is rosy in the luxury market – the slowdown in the Chinese market and a drop in tourism after the recent terror attacks in Europe mean that brands can no longer rely on China's label-conscious consumers to provide growth.

Companies are also facing a world where younger demographics and faster digitization and consumption are changing the way business works and how brands are perceived. And it is the latter factors that will drive inorganic growth in the years ahead.

Boomers and Millennials: Different strokes

Luxury brands need to appeal to the millennial generation or risk losing relevancy. A study by the US Census Bureau in April of this year found that the number of Millennials (18-34 year olds) had surpassed Baby Boomers (51-69) for the first time. And they are a very different consumer group from their more mature peers – more driven by sustainability and authenticity than previous generations.

"Millennials still want to spend their money on luxury but in ways that they feel are more appropriate [than previous generations]," says Gallot-Auberger. "They are changing the definition of luxury, focusing on experiences, not possessions – which means there is room for the luxury industry to develop high-end travel, offering unique and exclusive experiences, those that are not available to everyone. Millennials are more socially-aware, looking for products that are sustainable and brands that correspond to their values. Most large brands already have corporate social responsibility initiatives and, in terms of M&A, you're going to see them looking at acquiring niche brands with a clear social agenda and offering a more 'sustainable' product line."

Even more importantly, luxury brands will need to up their digital game: "Millennials would much rather have an experience looking at their mobiles and buying online than waste their time going into a store and being oversold by a salesperson," cautions Levey.

Digital growth and opportunities
Big luxury brands need to seize digital opportunities to gain competitive advantage. It is imperative that these companies construct an online experience to match the physical footprint that has traditionally served them well.

"Companies need to create an experience online where the consumer gets the same kind of luxury sensation as they do when walking into a prominent Fifth Avenue high-end luxury brand's store in New York," says Levey.

Companies are also looking toward a major shift to a "see now/buy now" model – in which catwalk fashions are immediately available in stores and online – and this will require a heavy investment in technology.

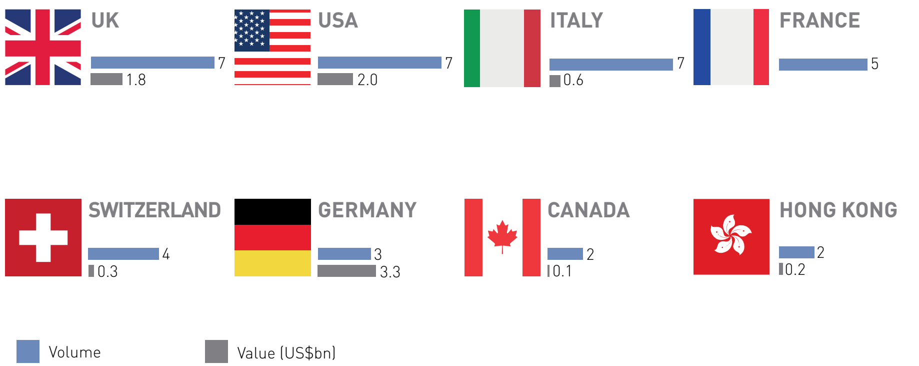
"Brands are starting to rethink the definition of seasonality. Brands are broadcasting a show live in the morning and you can buy the looks from the show that afternoon," says Gallot-Auberger.

"There is a huge logistical issue getting the product from the catwalk to the purchase point – either online or in-store. It will be hard for brands to put in place the necessary technology organically, which may well translate into JVs or acquisitions of tech companies that will give them the ability to meet the technological challenges quickly."

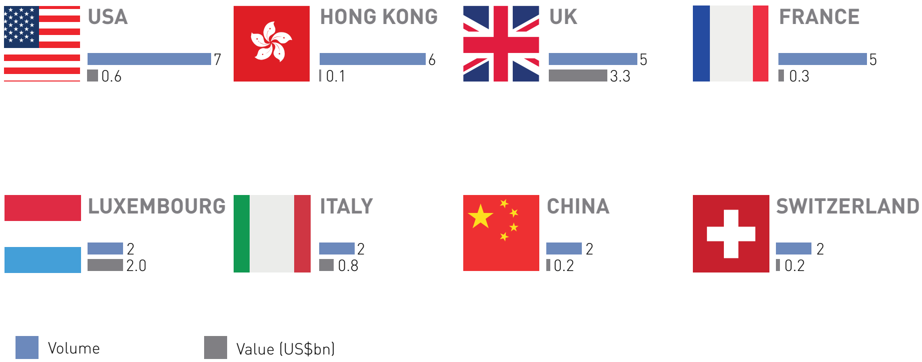
The luxury sector is at a crossroads. It is still a hugely lucrative industry – worth €250bn (US$281bn) in 2015, according to consultancy Bain – however, it needs to evolve to maximize reach and value.

Brands that reach into new geographies and sectors, tailor to Millennials and tame their technology with smart inorganic growth will be the ones that thrive.

MOST TARGETED COUNTRIES WITHIN LUXURY 2015-2016



MOST ACQUISITIVE COUNTRIES WITHIN LUXURY 2015-2016



4 SPOTLIGHT: W&I INSURANCE

Warranty and indemnity insurance – closing the gaps

The role of insurance in protecting buyers and sellers against risk of warranty breaches, by David Allen (M&A Partner, Baker McKenzie, London) and Jannan Crozier (M&A Partner, Baker McKenzie, London)

Warranty and indemnity insurance (W&I) (also known as representations and warranty insurance), increasingly features in M&A deals around the world. Initially prevalent in certain domestic markets, such as the UK, the US and Australia, it is now seen in a growing number of jurisdictions including Central Europe and south-east Asia.

In our experience, W&I can help buyers and sellers allocate risk on a deal in a way that is commercially acceptable to both parties, but care must first be taken to close potential gaps in cover.

Risk reallocation

W&I insurance contractually transfers a certain amount of risk inherent in acquisitions or disposals of businesses. Broadly, if used effectively, it protects the buyer or seller of a business from loss that may otherwise arise as a result of a successful claim for breach of a warranty under the sale and purchase agreement.

The conclusion of satisfactory policy terms is key. We have noted recent developments in the scope of policies that a would-be insured would be advised to consider early.

For example, while recovery under a W&I policy will be subject to a number of customary exclusions, there remain differences among underwriters' approaches. It is vital that those differences be apparent upfront. A marginal saving in premium may be a false economy if exclusions materially change between initial selection of the insurer and final policy negotiations, particularly if that occurs shortly before signing is scheduled.

The absence of "new breach" cover may also detract from the ability to recover loss. If there is a gap between signing and closing and, under the sale and purchase agreement, the seller is not liable for breach of warranty occurring after signing, the buyer will (if it proceeds to closing) bear the risk of any loss arising from breach. A W&I policy will exclude recovery for known liabilities (which are typically flushed out by requiring the insured to make a clean "no claims" declaration, and increasingly, "bring-down" or repeat warranties at closing which are disclosed against). This may be a real concern for buyers. We have seen underwriters (for example in Australia) willing to bridge this gap in cover for a limited period at an additional cost.

Growing trend of W&I

Despite potential gaps in cover under a policy, even in jurisdictions that have long been accustomed to W&I insurance, there has been a noticeable surge of interest in its use (for example in the US) over the past 12-18 months. This may be explained by:

- a fall in the cost of W&I insurance. When compared to deal value, typical transaction premiums now range from around 0.8-1.6% (in more established markets) rising to around 3% in less established markets or more litigious jurisdictions such as the US. We have also seen a willingness by some underwriters, particularly on large deals, to reduce the premium to take into account the policy excess or deductible reflected in the acquisition agreement;

- an increase in principals and their advisers experience as the use of W&I gains momentum and the process for putting W&I in place improves, becoming more aligned with the transaction timetable; and

- an increase in successful claims, with underwriters, in our experience, taking a sensible approach to recovery under policies.

Challenges and potential pitfalls

W&I insurance is not suitable for all transactions:

- local law regulatory issues may restrict the ability to insure a target and should be considered at an early stage;

- off-the-shelf policies must, as mentioned above, be negotiated and aligned to the transactional documents to avoid a gap in cover; and

- smaller deals may not justify the expense of premium, broker fees and adviser costs.

We recommend that a risk/benefit analysis be considered in all cases and policy terms obtained early on to avoid a compromising bargaining position shortly before signing.

Baker & McKenzie

Baker & McKenzie is the No. 1 cross-border M&A firm. Over the past 10 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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