# Our Insights into M&A Trends: Global Dynamics

January 2013

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# M&A – The Global Picture

With the turbulent year that was 2012 now behind us, it's a good time to reflect on how the global M&A markets fared and what we can expect to see in the year ahead.

2012 will be remembered as yet another challenging year for global M&A activity. The global macroeconomic slowdown, continued turmoil in the Eurozone and the potential for political change in a number of key markets all contributed to suppress the appetite for deal-doing. Despite many companies enjoying the benefit of a robust balance sheet and a reduction in average EBITDA multiples over the period combined with relatively stable equity markets, boardroom confidence for strategic M&A remained weak. M&A in 2012 fell 2.5% in value terms from 2011, although there was a glimmer of hope with a stronger performance in Q4 – particularly in the US.

Looking forward for 2013, the picture remains uncertain – but there are grounds for cautious optimism. The slowdown in activity over the past few years has resulted in an increasingly congested deal pipeline and there are many strategic deals to be done when the appetite returns. We are seeing growing confidence amongst many US corporates and, whilst the issue of the US debt ceiling looms on the horizon, we expect this confidence to contribute to an upturn in global M&A activity in 2013. If Mario Draghi is right to believe the risk of Eurozone fragmentation is behind us and we can move to a period of continued stability, one can anticipate a modest increase in European M&A activity, particularly amongst inbound investors seeking attractive acquisition opportunities whilst valuations remain relatively depressed.

However, in the short term the M&A landscape will remain volatile – companies need to continue to create shareholder value and outperform competitors, and so will continue to seek suitable opportunities where they can. We expect to see a number of trends developing, notably: companies in developed markets accessing the expanding consumer base in emerging markets, such as Africa, India and South East Asia; growth market buyers looking to purchase leading industrial technologies and luxury brands in developed markets. Finally, divestments of non-core businesses will continue throughout 2013, particularly in the financial institutions sector, as the impact of regulatory change and increased capital requirements drives further activity.

**Matthew Layton**
Global Head of Corporate, Clifford Chance LLP

**Visit our online resource:**
The Clifford Chance Global M&A Toolkit
*Clarifying the complex world of Global M&A*
www.cliffordchance.com/GlobalM&AToolkit

# Global activity levels

Global activity levels remain subdued, despite a spike in activity in the final quarter of 2012. For this to continue into 2013 will require confidence to return and the current macroeconomic volatility to subside

Global M&A in 2012 decreased 2.5% by value as compared with 2011, with transactions totalling US$ 2,177bn. This represents a 41% fall as compared with pre-financial crisis levels. The volume of M&A deals fell 4.3% from 2011, to 12,568 deals

However, there was a strong uptick in M&A deal value in Q4 2012, with US$ 674bn of deals announced in the final three months of the year, a 40% increase on the previous quarter. This was particularly evident in Europe, where Q4 saw an increase of 95% on the previous quarter

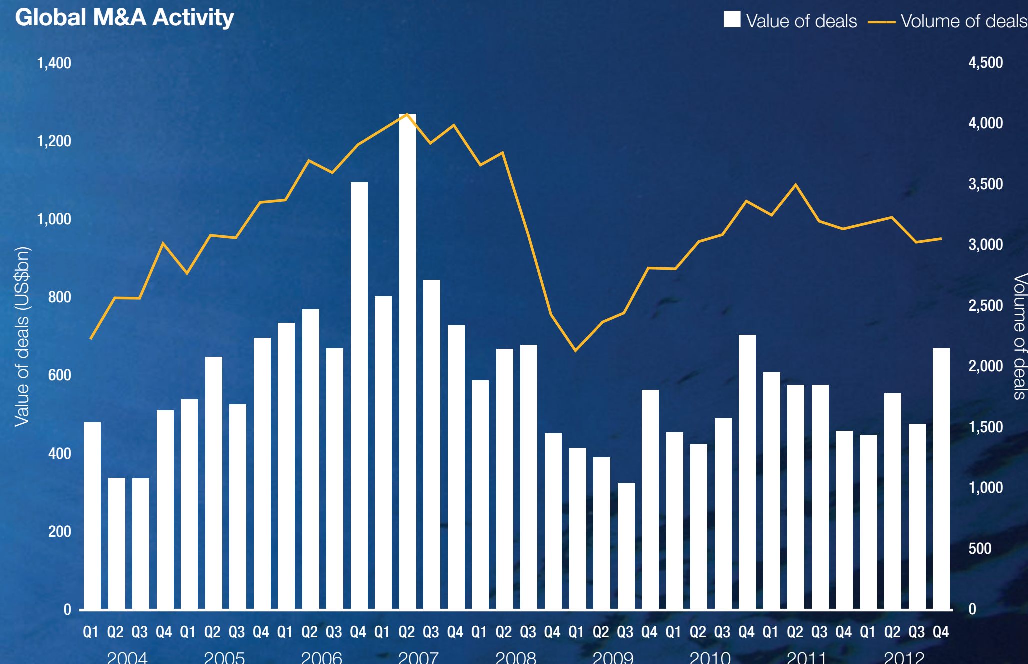
Cross-border M&A deals represented 40% of total activity in 2012, with deal values totalling US$ 879bn. Of this, US$ 588bn was M&A between regions (27% of total global M&A). The map on page 12 shows key M&A flows between the 5 principal regions

Energy, Mining and Utilities is once again the most active sector for M&A. 26% of all global M&A in 2012 was in this sector. Activity was boosted by Glencore's US$ 45.6bn merger with Xstrata and the Rosneft/TNK-BP deals

The emerging and high-growth markets were attractive to investors in 2012, with US$ 505bn of deals (23% of total global M&A) – an increase of 5% on 2011. 44% of cross-border M&A into emerging markets came from Europe

2012 was a slow year for private equity, with secondary buyout activity falling 13% from 2011, to just US$ 255bn. The general decrease was off-set by strong buyout activity in the US (46% of total buyout activity)

'Mega deals' (US$ 10bn+) made up 18% of the total value of global M&A in 2012, including Glencore's merger with Xstrata, Kraft Foods' spin-off of its snack business, Anheuser-Busch InBev's buyout of minority shareholders of Grupo Modelo, and Nestlé's purchase of Pfizer Nutrition*




Source: Data produced by Remark, taken from mergermarket.com

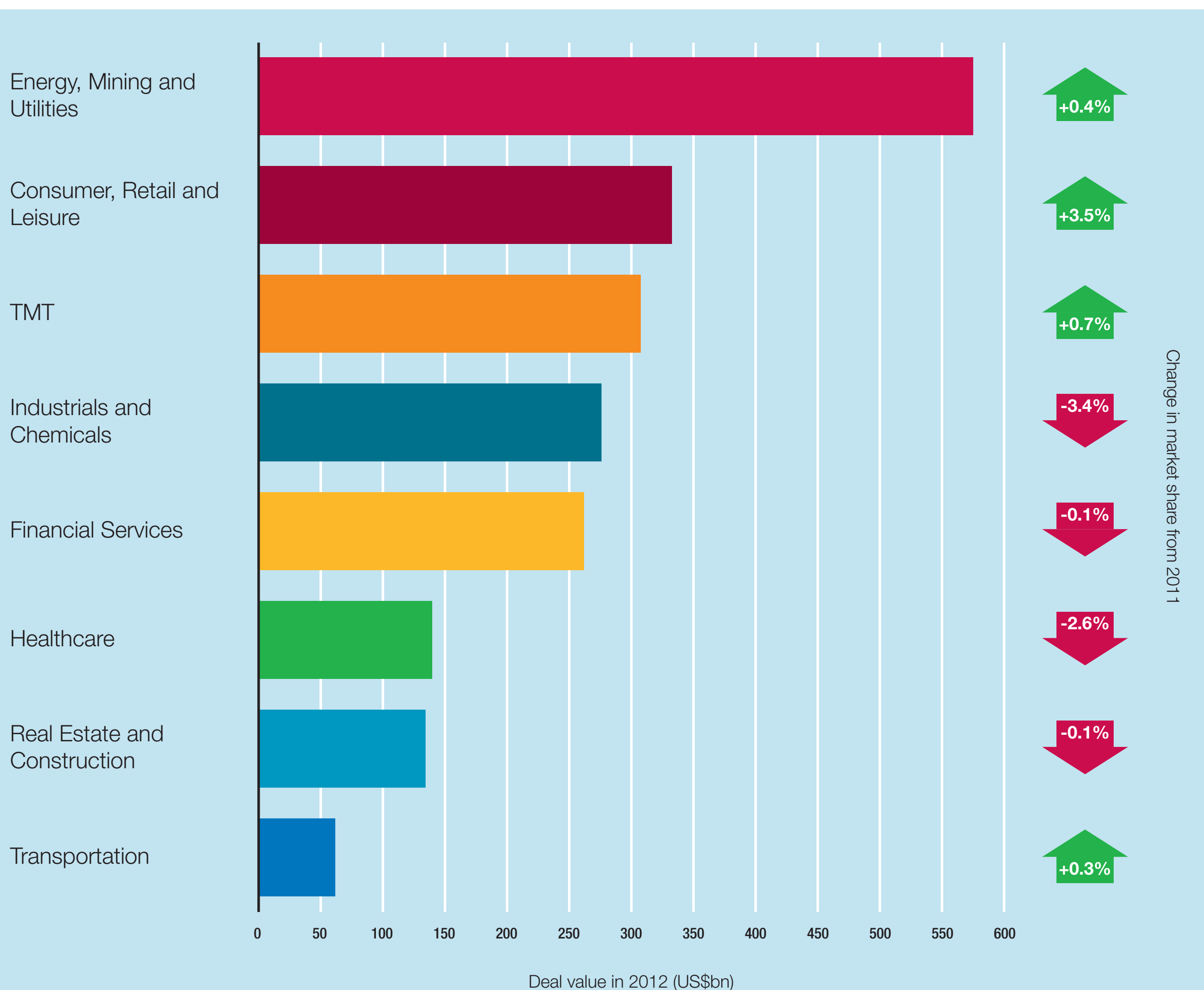
"The world economy is in flux in the wake of the global financial crisis, and we are seeing economic power shift from West to East. Developed nations are rebalancing their fragile economies and, whilst there will no doubt be bumps along the way, emerging and growth economies are now in the driving seat for global economic growth"

**Malcolm Sweeting,** Senior Partner

*Note: Clifford Chance had an advisory role in relation to each of these transactions

# Sector variations

Energy, Mining and Utilities remained active in 2012, as did the Consumer Goods and Retail sector which saw a significant increase in deal activity. The TMT sector also performed well, particularly relating to outsourcing in the cloud space and traditional telecoms activity in the US, Africa, Europe and Eurasia




Source: Data produced by Remark, taken from mergermarket.com

**Energy in US – David Evans, Energy Partner (Washington DC)**
"Unless the US shale revolution is severely restricted by environmental concerns, continued development of non-conventional hydrocarbons, located in shale and produced by hydraulic fracturing and horizontal drilling techniques, will dramatically change the US energy construct. This will generate more M&A activity, including (to the extent allowed by regulation) investment by State Owned Enterprises in energy, petrochemical or related assets"

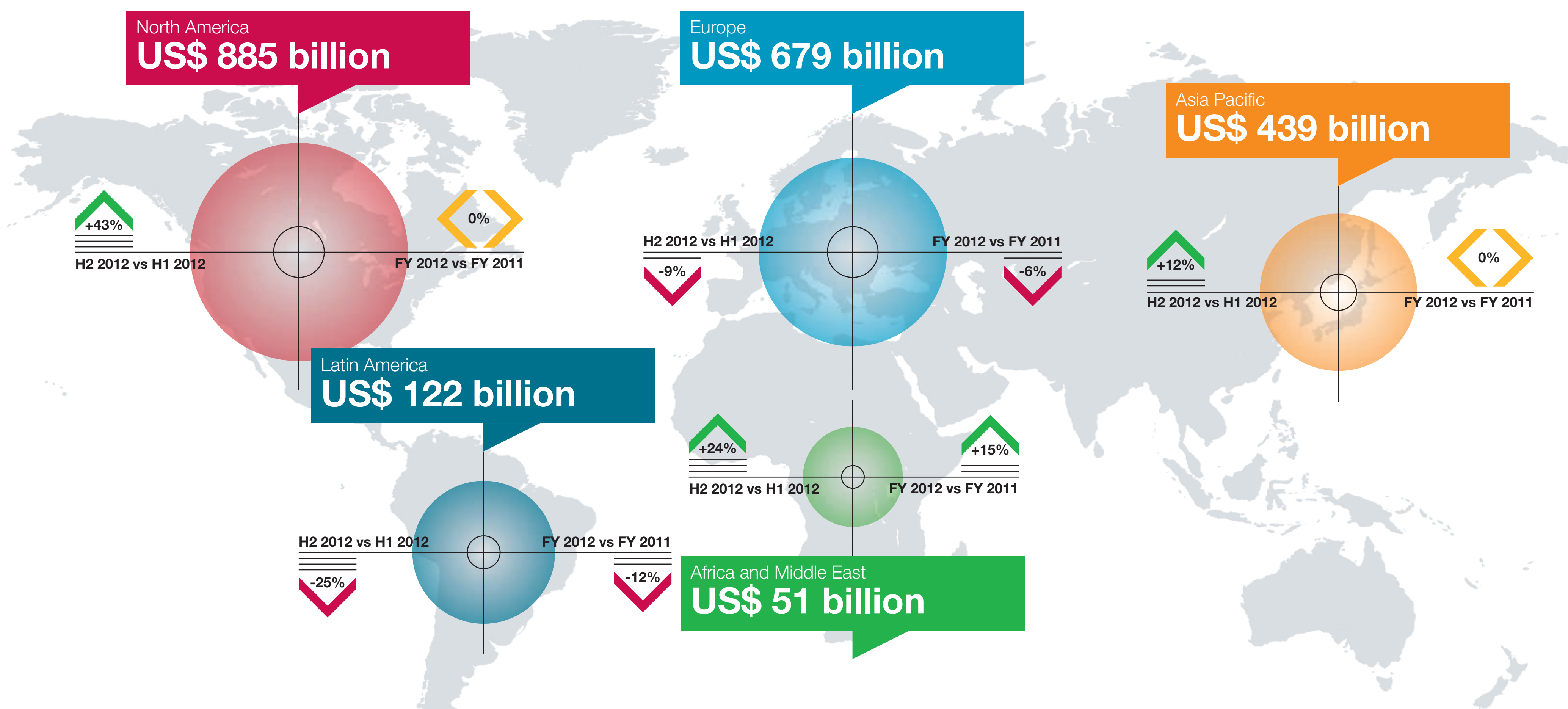
**Consumer in Middle East – Nigel Wellings, M&A Partner (Dubai)**
"From luxury brands through to quick-service restaurants, the sector remains buoyant, driven by continued high tourism rates and per capita income. Growth in retail is no longer a Dubai phenomenon, with Abu Dhabi and other GCC countries also experiencing growth. M&A is supporting this growth as brands look to move from a distributorship model to regional joint ventures, larger conglomerates look to add businesses and private equity also tries to play a part in allowing developing businesses to access capital"

**Industrials in Germany – C. Goldschmidt, M&A Partner (Frankfurt)**
"Industrials are constantly looking for strategically attractive targets. Due to the uncertain economic environment a number of transactions have been put on hold. However, if the economic outlook improves, this tailback of transactions will disperse as deals get done. In addition, consolidation in many sub-sectors will continue and we will see an increasing number of joint ventures"

**FIG in Asia – Roger Denny, Head of M&A in Asia Pacific**
"Regulatory change and strategic repositioning by financial institutions is giving rise to significant activity. We have seen RBS, ING, HSBC and Aviva pushing ahead with their strategies and disposing of banking and insurance businesses in Asia. We expect others to follow their lead. We are increasingly seeing Asian headquartered institutions as the buyers"

# Regional trends

Our map shows that 2012's subdued global M&A activity levels were principally due to reduced activity in Europe and Latin America. Despite M&A activity in North America and Asia Pacific remaining flat year-on-year, both regions experienced significant increases in the second half of 2012. Africa and Middle East was the only region to see a year-on-year rise




**Note: Interactive maps showing investment flows into and out of each region are available on the Clifford Chance Global M&A Toolkit www.cliffordchance.com/GlobalM&ATrends**

Data produced by Remark, taken from mergermarket.com

# Regional trends

## Key impacts in different regions

### US

- Uncertainty surrounding the US fiscal cliff negotiations and Dodd-Frank regulatory changes, volatile markets and continued pressures in the Eurozone have been suppressing M&A activity
- However, deal value recovered strongly in H2 2012, and as good fundamentals continue (high corporate cash balances, low interest rates, under-invested PE funds, sponsor-backed companies needing to exit and limited opportunities for organic growth), the outlook for 2013 is more positive, but tempered by the uncertainty created by the US debt ceiling and sequestration cuts
- 75% of US M&A (by value) was domestic, with inbound activity principally coming from Europe and Asia Pacific (11% each)

### Latin America

- Regional fall principally due to slowdown in Brazilian M&A, reflecting concerns about growing state intervention and protectionism, a slowing economy (inc. signs of increasing inflation), and new antitrust rules
- Outside Brazil, M&A activity is strong – generally experiencing good fundamentals (in terms of inflation, domestic demand/consumption and public debt) and political stability, and many areas are open to foreign investors. However there remains significant political risk in Argentina, Bolivia, Ecuador and Venezuela
- Infrastructure, energy, natural resources, financial services and consumer/retail are the key sectors driving M&A activity

### Europe

- 6% fall in 2012 activity would have been significantly greater absent Glencore/Xstrata and the sale of TNK-BP to Rosneft which together accounted for more than 15% of European M&A. Non-Eurozone M&A amounted to 56% of European M&A – the highest proportion for more than a decade
- In Southern Europe sellers have reduced price expectations, and this has led to increased deal flow – Portuguese deals rose to nearly US$ 20bn (a five-fold increase on 2011 levels)
- Subdued levels of inbound M&A activity in Russia were caused by concerns over fallout from presidential elections in March 2012, perceptions (not always well founded) of anti-foreign investment bias and general economic factors. Russian domestic M&A activity remained high, spurred by resolution of significant disputes (e.g. the sale of TNK-BP to Rosneft). Robust activity seen across CEE, especially Czech Republic, Romania and Poland

### Africa

- M&A driven by investors looking to achieve growth in their businesses by investing in some of the fastest growing economies in the world
- Energy, Mining and Utilities continues to dominate, representing nearly 60% of inbound M&A by value in 2012. Recent oil discoveries in Ghana, Uganda and Namibia, and the regulatory overhaul of the oil & gas industry in Nigeria, are likely to continue to drive activity in 2013
- Sectors such as telecoms, consumer and financial services are performing strongly as interest continues to grow along the entire value chain leading to the African consumer

### Asia Pacific

- M&A remained at 2011 levels – lack of confidence due to global economic conditions and Eurozone uncertainty is creating a headwind for companies executing M&A strategies in the immediate term
- However, no signs of M&A slowdown in certain Asian jurisdictions (e.g. South East Asia) and sectors (e.g. insurance, resources and CG&R)
- Dramatic slowdown in Australian M&A sparked by strength of Australian dollar (which has increased cost of resources production), combined with global drops in commodities prices. Any uptick dependent on changes to global indicators, weakening of dollar and narrowing of buyers'/sellers' expectations

### Middle East

- Key drivers for M&A include disposal of non-core assets; government-backed consolidation; restructuring-driven asset divestiture. Consumer-led businesses continue to perform well
- Political issues across the region continue to impact M&A, driving some movement of capital out of the relevant countries to the benefit of other more stable parts of the region
- Impact of announced infrastructure spend in Abu Dhabi, Saudi and UAE is beginning to flow into the market (e.g. in real estate sector). Tourism in UAE remains high, and property prices are moving upwards

# Key drivers and challenges for M&A in 2013

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# Key drivers for cross-border M&A in 2013...

## Cash on balance sheets
US$ 1.74tn held by US corporates alone

## Congested pipeline
resulting from low levels of recent M&A

## Drive for higher returns
by accessing emerging and high growth markets

## Need to create shareholder value
leading to divestments of non-core assets and spin-offs, having exhausted all internal restructuring options

## Ongoing fight for natural resources
driving M&A in certain markets

## Opportunism
as quality assets come onto the market through privatisations and divestments by distressed sellers, particularly in Europe

## Regulatory change
leading to divestments by financial institutions

## High-growth market bidders
accessing technology and brands in developed countries

## Age of PE portfolio investments
many assets ripe for exit

# ...and challenges for cross-border M&A in 2013

**Low growth environment**
economic slowdown in Asia, and flat/negative growth across much of Europe

**Uncertainty around measures/timescale for resolving Eurozone crisis**
but outlook is increasingly positive as fears of Euro fragmentation diminish

**Continued issues surrounding the fiscal cliff in the US**
sequestration cuts, debt ceiling and federal budget

**Access to finance and a potential return of volatile market conditions**
in the equity, debt and financial markets

**Difficulties achieving cross-border integration**
preventing realisation of expected synergies

**Uncertain political and fiscal environment**
holding back cross-border investments

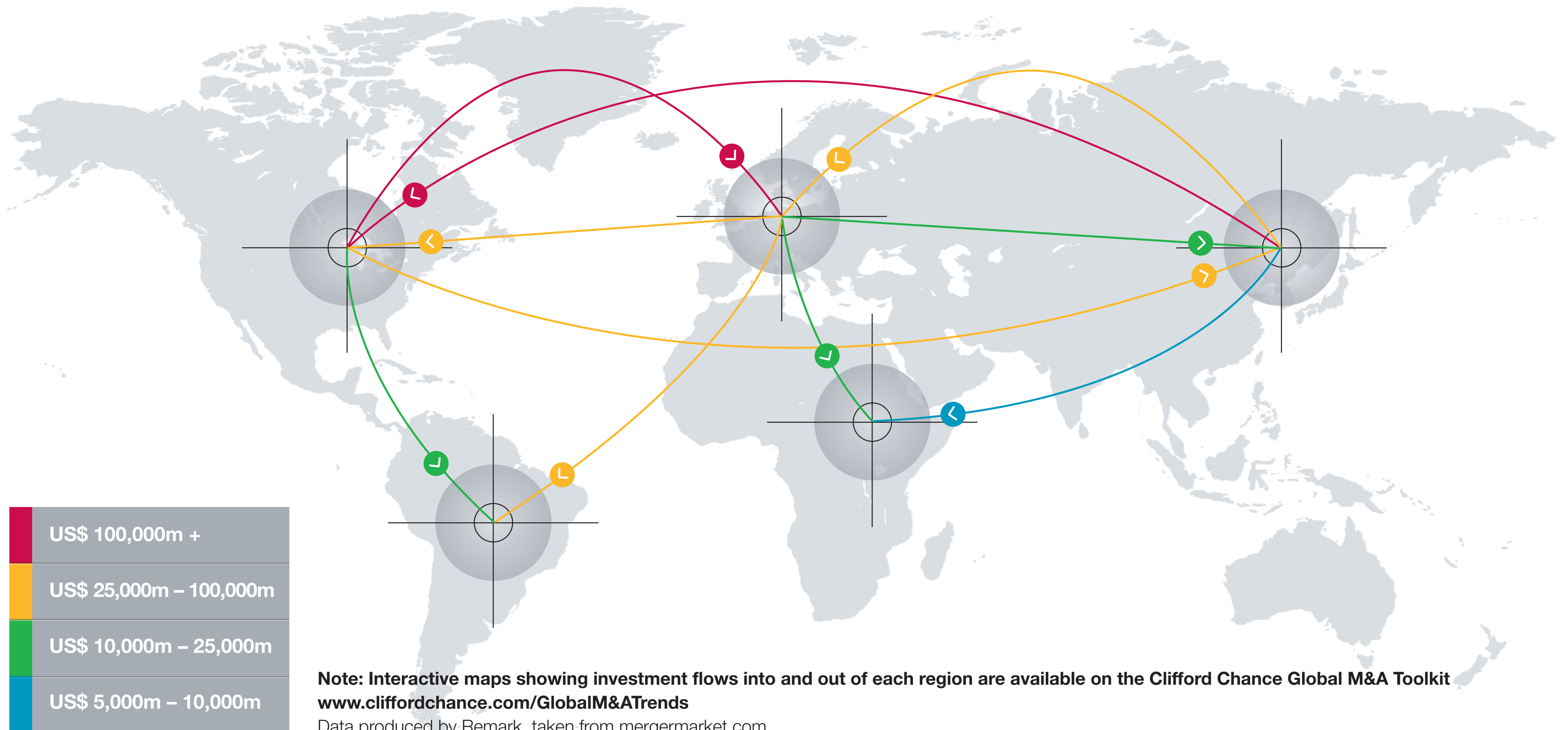
**Sovereign measures to protect natural resources**
and other protectionist measures

**Navigating the global regulatory environment**
antitrust and other regulatory regimes increasingly complex

**Shareholder pressure and activism**
an increasing influence on M&A activity

# Where's the money being invested?

Inter-regional cross-border M&A amounted to 27% of total M&A in 2012. Our heat map shows the value of the 2 greatest flows of cross-border inbound investment into each of the following regions: North America, Latin America, Asia Pacific, Europe, Africa and Middle East. The most significant investment flows were from North America into Europe (US$ 147bn) and from Asia Pacific into North America (US$ 112bn)

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# Trends in inter-regional M&A

We consider how the investment flows shown on the map opposite reflect deal activity in 2012, as compared with the previous year, and some of the key trends underpinning these activity levels

## North America

- Inbound: Cross-border M&A into North America grew by 46%, driven particularly by bidders from Asia Pacific and Europe
- Inbound: 60% of the US$ 112bn of M&A from Asia Pacific came from Japan (representing a three-fold increase in deal value from 2011), driven by the strong trend for outbound M&A by Japanese trading houses and corporates (e.g. Softbank/Sprint Nextel)
- Outbound: There was a 14% fall in outbound M&A from the US. The negative media outlook on Asia Pacific within the US resulted in a 28% fall in the value of US deals into Asia Pacific

## Europe

- Inbound: Although the value of M&A into Europe fell by 16%, volumes were only down 6%, suggesting that assets may be becoming available at more attractive valuations
- Inbound: Bidders based in North America were responsible for 68% (by value) of inbound M&A into Europe – Eaton Corporation's US$ 13bn acquisition of Cooper Industries was Europe's largest inbound deal in 2012
- Outbound: Although the number of outbound deals by European bidders fell in 2012, the total value of outbound M&A increased due to a handful of mega-deals (e.g. Nestlé's acquisition of Pfizer Nutrition)

## Asia Pacific

- Inbound: Total inbound M&A into Asia Pacific fell by nearly a third, and represented only 14% of total M&A in the region. The level of inbound M&A from European bidders fell by more than 50%
- Inbound: The 18% growth in Chinese M&A was driven by a significant increase in domestic activity; inbound M&A by European bidders fell by 93% to a mere US$ 420m, reflecting in part the uncertainty surrounding the 2012 leadership transition
- Outbound: The volume of outbound M&A from China has remained static, but Chinese bidders are undertaking larger deals, particularly targeting North America (e.g. CNOOC's bid for Nexen)

## Latin America

- Inbound: Inbound M&A experienced a 20% increase by value, leading to Latin America being the only region in which inbound M&A exceeds the value of intra-regional M&A
- Inbound: European M&A into the region increased by 90%, largely reflecting AB InBev's US$ 20.1bn acquisition of the remaining stake in Grupo Modelo
- Outbound: Total outbound M&A from Latin America more than doubled to US$ 23bn. Europe was the most popular investment destination, representing 57% of outbound M&A

## Africa and Middle East

- Inbound: Inbound M&A from Europe increased by 19%, overtaking Asia Pacific as the region responsible for the largest inbound M&A investment flow
- Inbound: Although inbound M&A into Africa/Middle East as a whole remained at 2011 levels, Africa saw a significant 39% increase by value
- Outbound: Despite the number of outbound deals from Africa/Middle East rising by 13%, there was a 51% fall by value

# Europe: significant investment opportunities are arising

Whilst the world's media tends to make sweeping generalisations, painting the Eurozone as a single investment destination, the reality is that opportunities and risks are different. Equally, non-Eurozone countries (including the UK, Switzerland and Scandinavia) may see new opportunities arising as they provide platforms for European access with reduced Euro currency risk

"Many Korean companies looking for growth in foreign markets are aggressively hunting for undervalued overseas assets. More and more of our clients believe that the current economic turmoil in Europe offers attractive opportunities for them to buy highly-coveted European assets at great value. If the Korean Won strengthens against the US Dollar/Euro, as is expected, this will also positively affect the prices of European assets"

**Hyun Kim,** Finance and M&A Partner (Seoul)

## Eurozone: a patchwork of investment opportunities and risks

### Germany/Benelux/Finland/Austria

- Strong balance sheets/cash reserves and relative immunity from the distress in other parts of Europe means sellers' valuations remain high and limited distressed opportunities are arising
- Investors are targeting strong industrial technology to develop home operations (e.g. Jianshu Jinsheng's acquisition of the textile machinery division of Oerlikon)

### France

- Market somewhat paralysed throughout 2012 due to Presidential elections and the consequent refocus of economic strategy
- Following this period of inertia, we expect that in 2013 large corporates will once again be able to make strategic decisions, seizing investment opportunities and executing divestment strategies
- PE sector remains slow due to recent legislative/tax measures having a particular impact on PE transactions (e.g. deal structuring and management incentive packages)

### Portugal/Greece/Slovenia

- Sovereign divestments now underway e.g. airports – particularly attractive to larger international buyers with strong cash positions, looking for right opportunities to expand/grow their core businesses; also purchasers from growth markets, including those with limited cross-border M&A experience
- In Greece, corruption concerns, low levels of tax collection, high labour costs and the continued risk of sovereign default/Euro exit are key risks deterring investment

### Ireland

- Ireland has successfully driven through strict austerity measures. Asset values and labour costs have fallen; political/economic stability, and low taxation rates mean strong investment potential
- Sales of diverse assets by Irish state entities are creating attractive investment opportunities

### Italy/Spain

- Distressed assets on the market. Sovereign divestments/privatisations also creating opportunities for infrastructure and strategic investment. Wave of disposals of non-core businesses by large corporates/financial institutions continues
- Top brand and retail/consumer industries being targeted by foreign/local competitors; financial investors also interested in assets generally (e.g. Qatar Holding's €2bn "Made in Italy" JV)
- Risk factors include political instability in Italy, and completion of banking system reorganisation in Spain. Whilst economic growth is not expected in 2013, general outlook is more positive and there are positive signs of recovery
- Company valuations are low, and interesting targets are available at attractive prices (e.g. Alitalia, Ansaldo, Avio in Italy)

# Challenges of investing in Europe

As the perceived risk of a major Euro failure diminishes, inbound investors into Europe still face challenges around the continued economic slowdown, increased political, regulator and media focus and cultural integration issues. Despite these challenges, we expect that 2013 will see increasing opportunities opening up across "old" Europe as sellers, including highly-leveraged sellers, dispose of non-core assets

**1 Outlook for operations in the Eurozone**

- Economic slowdown across Western Europe and deep recession in some countries, leading to lower demand for raw materials, products and services
- Increasing fiscal burden on businesses and/or consumers as result of austerity measures being implemented
- Risk of increased political interference in business and deal-making, as result of economic challenges and political/national sensitivities

**2 Cultural integration issues (language, culture, people)**

- Post-merger integration remains the key to a successful acquisition but acquirers consider that they lack the resources for integration*
- Whilst Europe is generally considered homogenous and developed in terms of economic and business culture, cultural integration issues sometimes disrupt plans for European acquisitions (e.g. by Japanese corporates)
- Integration considered easier in some jurisdictions (e.g. Ireland, Luxembourg, Switzerland) than others (e.g. Greece, Ukraine)

**3 Deal execution challenges**

- Political interference/protectionism comes to fore in challenging economic environment
- Purchasing from distressed sellers means lack of effective warranty/indemnity protection
- Purchasing from sovereign states raises particular issues (e.g. state aid)

**4 Exposure to Euro currency**

- Hedging FX risks
- Exposure to currency risks in the event of a state which exits the Euro
- Exposure to sovereign debt (or debt of Euro banks exposed to sovereign debt)

"Europe as a region is very diverse. Scandinavia, Benelux and the German-speaking countries will remain a refuge of stability where caution may prevail. The remainder of the Eurozone will be more dependent on the sovereign debt crisis trajectory and more volatile, hence providing significant opportunity for the bold. Although there is still work to be done, there is more evidence that the Euro monetary risk is under control due to the structural reforms that are in place"

**Arndt Stengel**, M&A Partner (Frankfurt)

* In our 2012 survey *Cross Border M&A: Perspectives on a Changing World*, 55% of global respondents said they are deterred from acquiring overseas because of the challenges of cultural integration

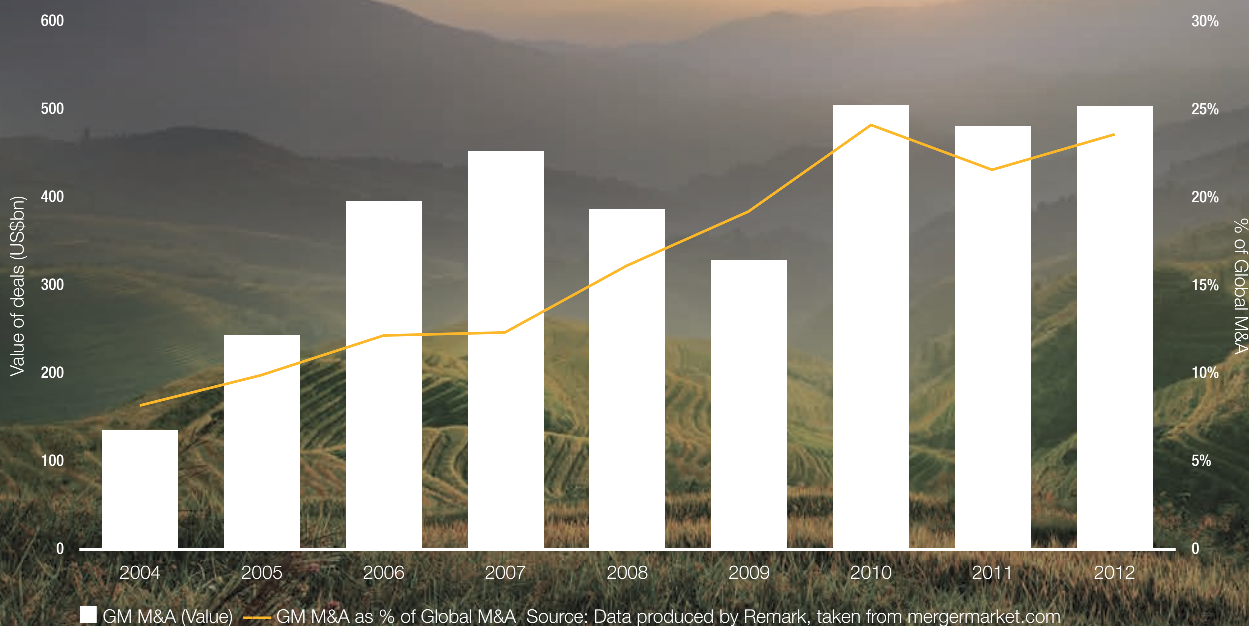
# Growth markets: drivers of M&A activity into 2013

Growth markets M&A performed strongly in 2012 increasing by 5% to US$ 505bn, close to its 2010 peak. We expect this trend to continue into 2013 as corporates and financial investors are forced to look outside the developed markets for returns. Bidders come from all regions, with different rationales – Asian buyers typically focus on resources for domestic demand (e.g. extractive industries) while buyers from the West target growing consumer bases

"Thriving markets stimulated by a surge of economic and population growth lead investors to examine opportunities in the growth markets – investors encounter challenges such as lack of available infrastructure and uncertainty in legal and tax regimes – yet opportunities exist and these challenges are navigable"

**Kem Ihenacho,** M&A Partner and Co-head of Africa Practice

**Growth Markets M&A Activity Trend**




Source: Data produced by Remark, taken from mergermarket.com

**Macroeconomic drivers**

- GDP growth
- Population growth, youthful population
- Rising disposable income; optimistic consumer class
- Demand for infrastructure developments
- Political stability (although some exceptions)

**Sector expansions**

- **Financial Services** – Prudential, the UK-based financial services group, acquiring Thailand's Thanachart Life Assurance for GBP 368m
- **Consumer goods and retail** – Diageo's US$ 2bn acquisition of India's United Spirits
- **Telecoms, media, technology** – France Telecom's US$ 3.2bn acquisition of the Egyptian Co. for Mobile Services
- **Energy, mining** – Rosneft's combined US$ 59.1bn acquisition of 100% of TNK-BP

Our recent webinar on "M&A in growth economies: challenges and opportunities" is available through the Clifford Chance Global M&A Toolkit www.cliffordchance.com/GlobalM&AToolkit

# Growth markets: focus on Africa

US$ 21,869m was invested into Africa during 2012 through 73 transactions. Interest in resources deals persists but M&A activity in 2012 was characterised by an increased focus on the African consumer. Middle classes with disposable income are growing rapidly and demand for consumer goods and services has soared with investors tracking the entire value chain leading to the African consumer

## Key trends in the region

### Resources dominate

The largest M&A transactions are dominated by resources deals from European multinationals (e.g. Shell's bid for Cove Energy) and from Asia (e.g. China Petrochemical Corporation's acquisition of a 20% stake in a Total Nigeria offshore oil block)

### Regulatory changes

M&A activity in oil and gas in Nigeria is being stimulated by a regulatory overhaul. Regulatory change creates an opportunity for local players backed by international finance – see Helios' backing of Eland Oil & Gas which acquired a US$ 600m on-shore licence from Shell in 2011

### Consumer facing

The growth of the African middle class with increased spending power is a significant driver of activity. Carlyle's investment in Export Trading Group, an agricultural – processing and commodity business, is a good example of investing in a business driven by consumer growth. Other significant deals include: Walmart's US$ 2.1bn acquisition of South African retailer Massmart; and Kraft's buy-out of the remaining 50% stake in Moroccan biscuit- maker BIMO

### Telecoms

Africa is the fastest growing telecoms market in the world and remains under-penetrated by developed market standards. Non-voice usage is driving demand for data and the telecoms infrastructure to support it. Consolidation between operators is likely to continue, as is continued innovation in asset sharing such as telecom tower sale and leaseback transactions

### Financial services

Consolidation amongst banks across Africa is expected to continue (e.g. Barclays consolidating its African businesses and increasing its stake in South Africa's ABSA). So too is "de-globalisation" with the sale of Société Générale's Egyptian business to QNB being a recent example of this trend

### Private equity

The size and number of funds continue to increase. Global PE funds (not just specialists) are targeting the market with dedicated funds and institutional investors are increasingly looking to commit capital to African sponsors. Domestic pension funds are unlocking allocations to PE as seen in Botswana and Nigeria

# Financing M&A: trends in the current economic environment

Reduced bank lending opportunities, lack of IPO activity and stagnant equity capital markets are forcing companies across all sectors to seek innovative methods to finance M&A transactions as an alternative to traditional sources of financing

## Challenges

- Continuing uncertainty in the Eurozone
- Regulatory changes impacting on financial institutions
- Sharp decrease in bank lending/acquisition finance – M&A bank lending fell to a 13 year low in 2012 according to Reuters
- Limited ECM opportunities
- IPO markets effectively closed – 2012 was the worst year in terms of global IPO volumes since the depths of the financial crisis, according to Dealogic

## Companies are finding new ways to finance strategic acquisitions:

- **Private Equity:** more sponsor-backed deals and JVs with strategic investors (e.g. ArcelorMittal acquired Baffinland Iron Mines through a joint cash bid with EMG). Greater use of combined bond/loan structures (e.g. super senior revolving credit facilities)
- **Energy:** more supply chain financing, asset swap structures (e.g. BASF to hand over to Gazprom its stakes in European gas businesses in return for 25-50% stake in Siberian gasfields), JVs with strategic investors, or share for share acquisitions (e.g. Petroceltic's acquisition of Melrose)
- **TMT:** extensive cash on balance sheets of TMT companies is being employed (e.g. Sprint's proposed acquisition of Clearwire), particularly by US corporations. However the impact of US repatriation taxes may continue to affect this trend in 2013
- **Real Estate:** listed companies may access the corporate bond market, whilst other real estate participants may continue to turn to "new finance providers" (such as insurance companies) or JVs with capital-rich entities (such as SWFs or pension funds)
- **CG&R:** retail companies with strong balance sheets increasingly using cash; also accessing debt markets to obtain investment capital (e.g. Amazon's US$ 3bn debt offering – its largest in a decade)

"There is no shortage of finance for highly rated borrowers – both in terms of the capital markets and bank lending. Other borrowers are having to look at other forms of debt finance and be more flexible in their approach. There is no doubt that the shadow banking industry is expanding daily"

**Robert Lee,** Co-head of London Finance practice

# Financing M&A: regional trends

## Key impacts in different regions

### US

- Significant levels of cash on corporate balance sheets, but lack of confidence
- Lowest cost of investment grade and high-yield debt in almost 20 years
- Equity markets available for seasoned companies but other sources of capital are more attractive
- Bank lending is preferred source of financing M&A for large corporates and remains available for credit-worthy companies

### Latin America

- M&A traditionally financed from purchaser's own resources
- Limited use of acquisition financing, due to high interest rates and underdevelopment of the banking system for this type of lending. This is expected to change due to: banks' increasing appetite to expand this business, higher lending capacity of banks resulting from consolidation/reorganisation of credit entities, and easing of monetary restrictions/lowering of interest rates by certain governments
- Financing of matured infrastructure M&A is very developed and offers liquidity to investors
- Bond financing market is at early stage of development

### Western Europe

- Cash on balance sheets of European corporates but continued lack of confidence means cash is not being unlocked
- In some parts of Europe the equity portion of financing is increasing vs. bank debt
- Many European companies are facing a refinancing wall, and are looking for solutions – senior secured bonds may come out as best alternative to bank debt

### Africa

- M&A traditionally financed with cash
- Debt available for certain sectors (eg reserve-based facilities for appropriate oil and gas deals)
- Continued and increasing interest from private equity – both emerging market focussed PE houses and global funds

### Asia Pacific

- Cash-rich companies looking for growth opportunities with strong and healthy balance sheets, combined with access to cheap debt, is enabling them to pursue opportunities outside their home markets where there is less competition for assets
- Japanese corporates are tending to finance acquisitions from their balance sheet/straight bank loans
- Financing remains difficult in Australia

### Middle East

- Transactions mostly financed by own account cash, possibly backed by corporate debt facilities, but generally generated by the operations of the acquiror
- A few of the larger consolidation mergers structured using equity. Joint ventures also established through asset contribution with no cash, although legal regimes can make these difficult
- Debt capital markets remain open for the right businesses (principally GREs and Financial Institutions). There is also deep regional liquidity for Islamic paper. Lack of debt has led to some vendor financing being seen in the market

# Managing risks in global M&A

**22** Navigating political pressures and protectionism

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# Navigating political pressures and protectionism

Protectionism is increasing, particularly towards acquisitions by Chinese companies which are facing intense regulatory scrutiny in North America, and resource nationalism is on the rise

## North America: National security concerns

- The Committee on Foreign Investment in the US (CFIUS) and President Obama blocked the acquisition by Chinese-owned company Ralls Corp of four wind farm sites in Oregon close to a US Navy airbase
- Annual CFIUS report to Congress identified for the first time (since the annual reporting requirement was introduced) a likely "coordinated strategy" of one or more foreign governments or companies to acquire US companies with critical technologies (but did not disclose details)
- Ongoing review of Wanxiang/A123 (advanced batteries) deal
- Canada's Prime Minister announced a more restrictive approach to acquisitions by state-owned companies: *"To be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our own governments only to see them bought and controlled by foreign governments instead"*

## Europe: More welcoming?

EU governments appear more concerned with preventing flight of existing jobs and investments than with rejecting new foreign investment on national security grounds:

- Proposed merger of BAE and EADS abandoned after EU governments failed to agree on their respective levels of influence over the company. Ability to influence the location of its investments and jobs was reported to be a key concern
- ArcelorMittal's announced closure of production assets in France triggered threats of forced nationalisation from the French government
- The UK government raised no objections to CNOOC obtaining control of the UK's largest oil field, through its acquisition of Nexen

However, even if there are fewer obstacles under foreign investment laws, State-owned buyers could face tougher merger control reviews. The European Commission has indicated that it might view multiple Chinese state-owned companies as forming a single, commonly-controlled undertaking for competition law purposes, which could inhibit future deals

## Worldwide: Resource nationalism on the rise

In recent years, there has been a marked increase in nationalisation or expropriation of foreign-owned assets in Latin America, Asia and Africa and this trend looks set to continue in 2013

In particular, cross-border M&A may be seen as an opportunity for a State to change the terms of a resource exploration and production arrangement in its favour for strategic or nationalistic reasons

For example:

- The Mozambique government demanded a "fair amount" in taxes as a condition of clearing the transfer of Cove Energy's exploration licence to its new owner PTT
- The Mongolian government blocked Chalco's acquisition of SouthGobi Resources (Mongolian coal miner) after stating it would revoke SouthGobi's licenses if it was owned by Chalco
- In Indonesia, it was announced that foreign ownership of certain mines would in due course be capped at 49%

# Spotlight on CNOOC/Nexen

Clearance of the CNOOC/Nexen deal by the Canadian regulators in December 2012 (it remains subject to CFIUS clearance) was in part the result of a different approach by CNOOC to M&A deals in North America. While foreign state-owned buyers will now have to contend with Canada's new policies on acquisitions of its assets by foreign state-owned entities, private buyers may find a useful route map in CNOOC's approach to the Nexen deal

**2005 failed attempt to buy Unocal in the US**

Surprise offer for Unocal caught the US and rival bidder (Chevron) off guard and CNOOC was forced to go on the defensive:

- CNOOC was perceived as an aggressive Chinese acquirer by US politicians concerned about national security and a huge lobbying effort to block the deal took place
- CNOOC was not able to convince the US political groups that it had a strong justification for the bid or that its motivations were benign

**2005 CNOOC purchased a stake in MEG Energy in Canada**

- Between 2005-2012, CNOOC acquired a number of North American assets and minority stakes in North American companies, for example, in 2011 it signed two multibillion-dollar shale oil deals with Chesapeake Energy

**2011 CNOOC bought bankrupt oil sands producer Opti Canada**

- Opti's main asset was its 35% stake in the Long Lake oil sands project in Alberta, in which Opti's partner was Nexen. CNOOC worked closely with Nexen to tackle the challenges at Long Lake
- This acquisition helped CNOOC to: (i) develop a relationship with Nexen and obtain knowledge of Nexen's operations and assets and (ii) get to know the provincial and federal regulators and the local communities

**2012 Canada's government cleared CNOOC's US$ 18bn takeover of Nexen**

CNOOC alleviated political/regulatory concerns by:

- informally approaching officials prior to announcement, in regions where Nexen has assets
- moving its North American HQ to Calgary and making a guarantee to retain Nexen's employees
- offering to list its shares on Toronto Exchange
- agreeing to file annual compliance report to Industry Canada

"Political risk, not least in the form of regulatory approval for foreign investment, continues to be a real issue – in particular where the acquiror is state-owned. Chinese companies are increasingly looking overseas for acquisition targets in the energy, telecommunications and finance sectors. China's foray into overseas direct investment has been carefully scrutinised in a number of jurisdictions (most recently in Canada and the US) with some deals collapsing, as China's companies bow to public and political pressure fuelled by protectionist tendencies. Chinese companies are increasingly turning to firms with an established presence in the Mainland and a global footprint to support their expansion, and to navigate them through the myriad of often complex foreign investment and merger control regimes"

**Emma Davies**, M&A Partner (Hong Kong/China)

# Political and reputational risk

The past year has demonstrated the potential impact of reputational risk, even where a company is acting within the law. When planning their M&A strategies, companies need to be aware of the risk that politicians or the media may perceive their actions as “morally” wrong, which can then lead to anything from calls for consumer boycotts to threatened nationalisation of the business

## Recent examples of companies exposed to political and reputational risk

Starbucks, Google and Amazon received significant negative press and were called before the Public Accounts Committee in the UK over the amounts of corporation tax they had paid, even though they had all complied with applicable tax laws. As a result of public pressure, Starbucks agreed to pay an additional GBP 20m in tax over the next two years

ArcelorMittal announced in 2012 that it was to close two unprofitable blast furnaces in France with the loss of 629 jobs. It subsequently gave a commitment to the French government to keep the furnaces open to avoid a potential nationalisation of the plant

News Corporation withdrew its bid to acquire full control of BSkyB in July 2011 due to issues relating to voicemail interception at one of its subsidiaries. News Corporation has subsequently decided to spin off its newspaper business. The press has suggested that this is at least in part to protect the reputation of News Corporation’s broadcasting business

## Political and reputational risk in the M&A context

- Ensure that due diligence looks at wider issues than just compliance with local laws
- Consider how reputational issues affecting the target could affect the acquiring company or new business
- If the new or merged business will take a different approach on sensitive issues, make this clear
- Respond to criticism promptly and thoroughly or others will set the agenda
- Be aware of the position of relevant governments on key issues, and ensure that their support is never taken for granted
- An M&A transaction can be part of the solution to address a particular situation in a manner which protects shareholder value

“Compliance with the letter of the law alone is not sufficient to guard against reputational risk. Companies must also be aware of the wider business environment and the strength of public feeling on issues affecting their own businesses or those that they are considering acquiring”

**Jeremy Sandelson**, Global Head of Litigation and Dispute Resolution

# Tax risk: An uncertain global tax environment

The difficult economic climate has resulted in governments around the world taking a more active approach to prop up falling tax revenues. This has manifested itself in increased scrutiny of tax planning and frequent changes in law which has created an uncertain tax environment

Two particular trends which are having an impact in the context of M&A transactions are:

- Renewed focus on tax deductibility of interest on acquisition debt. This is making it more difficult to achieve tax efficiencies through debt "push down"
- Scrutiny of tax efficient business structures adopted by multinationals (e.g. use of low tax jurisdictions as profit centres). This is likely to make it harder to integrate acquisitions tax efficiently

"The climate is extremely adverse to any type of tax saving and the line between legitimate structuring and abuse is disappearing. Tax planning is now getting media attention and the big players in the digital economy are being portrayed as the biggest tax offenders; they might find themselves confronted on transfer pricing and permanent establishment exposure sooner rather than later"

Carlo Galli, Tax Partner (Milan)

# Alternative deal structures

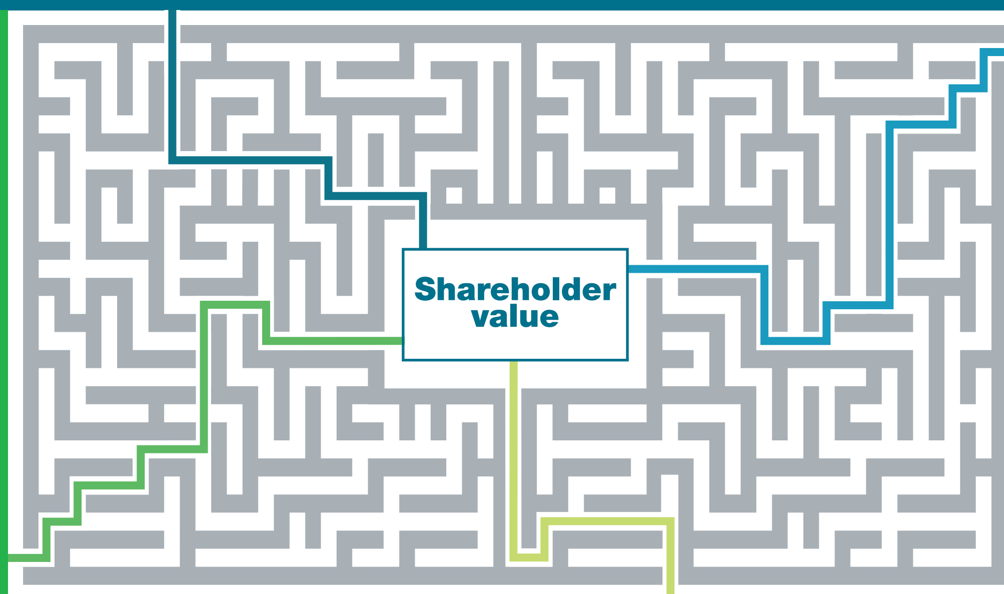
The need to establish growth but without the risks inherent in full acquisitions is causing boards to look at all options to create shareholder value. We expect companies across all regions to continue to pursue alternatives to traditional acquisitions in 2013

## Strategic tie-ups

- The industrial logic of combining Xstrata's diversified mining operations and Glencore's commodity trading expertise was the rationale behind that mega-deal. Securing access to raw materials at an acceptable price is likely to drive vertical integration transactions in a number of industries (e.g. steel)
- The proposed (now aborted) tie-up between EADS and BAE Systems highlighted the political sensitivities which often need to be addressed (particularly in certain industries) and the potential role for innovative deal structures, in this case a dual-listed company structure

## Joint ventures

- Provide opportunity to share financial, cultural and political risk – a particular feature in emerging markets
- May enable foreign ownership restrictions and antitrust considerations to be navigated successfully
- Often used as a stepping-stone to acquire 100% (e.g. Walgreen/Alliance Boots)
- High-profile examples announced in 2012 include the thermal power joint venture between Hitachi/Mitsubishi Heavy Industries, and Penguin/Random House




## Spin-offs and demergers

- Dividing a company with an underperforming share price into two distinct businesses enables investors to align holdings with investment objectives and often creates value
- Separate businesses enables corporate resources to be allocated in accordance with each company's strategic priorities
- Demerged entities typically more susceptible to future takeovers than other companies
- High-profile examples in 2012 include Kraft Foods' demerger and Abbot Laboratories' spin-off of AbbVie, which was 2012's largest deal

## Franchises

- May enable overseas companies to establish a presence in markets with foreign business ownership prohibitions or restrictions
- Partnering with a local player also helps to mitigate risk when accessing new markets
- Recent high-profile examples include French retailer Auchan's entry into the Indian market through Max Hypermarket, and Lipsy's entry into a number of markets across the Middle East with Dubai-based Landmark Group

# Alternative deal structures: focus on public minority buy-outs

Corporates with listed subsidiaries undertook buy-outs of the public minorities in some of 2012's largest deals. These transactions significantly reduce many of the financial, political and cultural risks inherent in acquiring 100% of a new business. However, there are a number of commercial, reputational and legal considerations which companies embarking on these transactions need to take into account

| Target | Bidder | Transaction | Consideration | Rationale |
|---|---|---|---|---|
| Grupo Modelo (Mexico) | AB InBev (Belgium) | Acquisition of 49.7% public float by existing 50.3% shareholder | US$ 20.1bn cash | Global distribution, technology and branding synergies |
| International Power (UK) | GDF SUEZ (France) | Acquisition of 30% public float by existing 70% shareholder | US$ 10.9bn cash | Increased access to growth markets and synergy benefits |
| Clearwire Corporation (US) | Sprint Nextel Corporation (US) | Acquisition of 49.6% public float by existing 50.4% shareholder – pending (note: Clearwire received a competing bid from DISH Network Corporation) | US$ 2.2 bn cash | An enhanced spectrum portfolio resulting in operational efficiencies and improved customer service |

## Insight from the US

Because US Delaware courts apply the highest level of judicial scrutiny to public minority buyouts, class action lawsuits alleging that the target board has or will breach its fiduciary duties by adopting the controlling stockholder's proposal are almost always filed.

Target boards can protect themselves by appointing a special committee of independent directors. However, as evidenced by the Delaware Supreme Court decision in *Southern Peru* in August 2012, the special committee needs a robust mandate to engage in arms' length negotiations and is required to act independently. The Court found that the buyout was unfair due to the appearance that the special committee was trying to justify the price as fair through, among other things, the use of unconventional valuation metrics and affirmed a US$ 2bn damages award – the difference between the actual price paid and what the price should have been if the transaction had been undertaken at a fair price.

# Spotlights from around the globe

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## Private Equity – mixed messages?

**by David Walker, Global Head of Private Equity**

2012 was a mixed year for private equity. The challenging macroeconomic environment meant a reduced volume of quality assets coming to market and uncertainty in the financial markets continued to affect the availability of debt. However, the pressure to put money to work meant that the best assets attracted considerable financing interest, making auction sales for attractive assets (if not pre-empted by an off-market approach, whether solicited or not) highly competitive. The market remains challenging for less attractive assets. For those that see the light of day, deals are taking longer and financing is difficult. But many do not: nervousness abounds with sellers adopting a "wait and see" approach rather than risk the perceived stigma of a failed auction. There is a clear imbalance between the pressure to buy and the pressure to sell.

Outside of auction processes, sourcing deals continues to be difficult but sponsors are adapting to the market. We see use of "buy and build" strategies to consolidate fragmented markets. Using portfolio companies to make acquisitions can give sponsors a competitive edge for sourcing deals as well as opportunities to extract synergies.

Regulatory changes continue to stimulate activity, particularly in the FIG sector. We expect further "spin outs" of private equity and infrastructure businesses from financial institutions. Overall, private equity transactions are tracking global M&A trends, both in terms of geographical regions and deal types. We see an increase in Africa-focused funds and global funds raising capital to deploy in Africa or to acquire businesses with African exposure. Other deals in the year, such as EQT's acquisition of Vertu or Silver Lake and Partners Group's purchase of Global Blue, show private equity's appetite for businesses with exposure to high growth markets. In the developed markets, and Europe in particular, defensive sectors such as professional services and healthcare have seen considerable activity, which we expect to continue.

## Trends in Asia

**by Neeraj Budhwani, M&A Partner (Hong Kong), commenting on the Clifford Chance FinanceAsia Survey 2012**

Global economic conditions continue to be the biggest drag on M&A (76%), but concerns about protectionism and regulatory issues (66%), and unrealistic price expectations (55%) are also amongst the top issues casting a shadow over M&A activity.

The main drivers for outbound M&A activity from Asia are the race to secure supplies of natural resources (63%), Asian companies adopting global strategies (57%) and taking advantage of depressed valuations in target markets (46%).

In terms of target jurisdictions in Asia, China remains the most popular single market (59%) with Indonesia in a close second (52%). However South East Asia as a block tops the popularity stakes.

Resources still dominate as the hottest M&A sector with Oil & Gas (52%), and Mining (44%) top of the list; also Consumer Goods & Retail performing strongly (36%). Mining interest has however cooled down, with a drop of 23% over the previous year.

Our publication: *Insights into Asia Pacific M&A – FinanceAsia and Clifford Chance M&A Survey* is available through the Clifford Chance Global M&A Toolkit www.cliffordchance.com/GlobalM&AToolkit

# The Politics of US Energy

**by David Evans, Partner in Energy Sector (Washington DC)**

Though energy has always been a politically emotive issue in the US, the US does not have a specific "national energy plan". The US's current plan is a laissez-faire, market-based approach which responds to price signals, not much else.

Developments in international markets and geopolitical events have historically had dramatic impacts on the US energy market, but development of North American indigenous energy supplies is mitigating the US dependence on foreign supplies and truly constitutes a "game changer".

**US Recent Reversal of Fortunes – The Shale Revolution**
Past concerns on domestic dependence on foreign oil and gas supplies have given way to concerns on the challenges and risks of developing the US's vast and newly accessible sources of natural gas and oil produced by hydraulic fracturing and horizontal drilling techniques.

Recent analyses by the International Energy Association and Exxon conclude that North America will become a net exporter of energy within the next 15 years. Due to non-conventional production from US shale formations and Canadian tar sands, the continent has the potential to change the world-wide energy market.

In 2011, the US produced more natural gas than the Russian Federation; this change from shortage to adequate levels of supply occurred rapidly – over approximately six years. There is now a need for massive investment to develop and transport the new shale supplies to major markets.

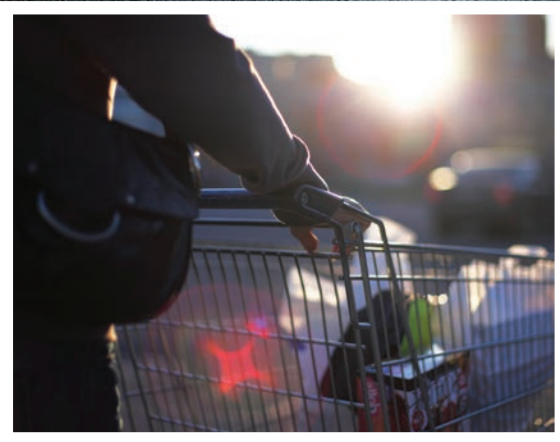
The regulatory process, however, is challenging and politicized and varies from state to state. Environmental concerns have blocked projects, notably the Keystone pipeline. Some foreign investments could be blocked under CFIUS.

**US M&A Activity in the Energy Sector**

- Energy, Mining & Utilities was the most active sector in US in 2012 with US$ 161bn-worth of deals, accounting for 21.9% of US M&A
- 3 of the top ten deals in the US in 2012 were in the Energy, Mining & Utilities sector, including ConocoPhillips spinning off its downstream operations valued at US$ 20.8bn

## Liberalisation of foreign direct investment policy in India

**by Mark Poulton, Head of M&A India Group**



The Government of India has finally introduced a set of reforms to liberalise foreign direct investment policy in key sectors such as multi-brand retail trading, aviation, broadcasting and power exchanges. This marks a major step towards boosting investment in these sectors.

Taking multi-brand retail trading as an example, global retailers can now enter the Indian retail market by investing up to 51%, with prior Government approval. Foreign investors must make a minimum investment of US$ 100 million, with at least 50% to be invested in 'back-end infrastructure' within three years; at least 30% of products must be sourced from 'small industries' (plant and machinery investment not exceeding US$ 1 million).

The implementation of the policy has been left at the discretion of individual states in India. Some states including Delhi and Maharashtra have already approved implementation of the policy. The policy has been warmly welcomed by global multi-brand retailers who will now be allowed to explore joint venture opportunities with Indian partners. There will also be opportunities for related logistics, technology and infrastructure businesses.

The Government of India expects the policy to have a positive impact on India's economic development, creating job opportunities, improving technology and infrastructure, helping farmers and small manufacturers, benefiting consumers both in terms of quality as well as price, and boosting real estate development.

## Risk mitigation in Latin America

**by Javier Amantegui, Co-Head of Latin America Group**

Investing in Latin America requires additional planning compared with deals in other jurisdictions as a result of the unique risks involved in doing deals in this growth market.

For instance, to reduce political risk or to invest in protected sectors such as energy or natural resources, investors may wish to invest along with local governments or look for the best possible Bilateral Investment Treaties. To enter into regulated sectors like financial institutions, infrastructure or TMT, joint ventures with local partners seem to be the most sensible path to regional acceptance and long-term success.

In addition to the risks which are unique to growth markets, traditional structuring issues such as the availability of acquisition finance, the robustness of an exit strategy and tax planning also apply. For example, a transaction in Central America faced difficulties in structuring the financing of the deal as local banks had exceeded their lending volume limits for a single deal.

Tax planning is an essential element of any investment strategy in Latin America, as it is not easy to repatriate earnings efficiently in countries with few double-tax treaties in place. In addition, it may be that elements of a deal's tax planning conflict with an investor's preferred Bilateral Investment Treaty structure, which is not common in developed market deals. It is also worth mentioning that BIT protection continues to be advisable for acquisitions in the region.

## Improving the investment climate in Russia

**by Torsten Syrbe, M&A Partner (Moscow)**

The Russian Direct Investment Fund (RDIF) is a US$ 10bn fund which was established by the Russian government in June 2011 as part of a broader initiative to improve the investment climate of Russia and establish Moscow as an international financial centre. RDIF seeks to make equity investments in high-growth sectors of the Russian economy.

RDIF operates on a co-investment model, investing alongside international investors. For every dollar invested by RDIF, at least one dollar must be invested by a qualified co-investor. In this way, RDIF seeks to bring new technologies, international best practices and highly qualified managers to Russia. For international investors, RDIF enables increased access to large deals and growth opportunities in the Russian market, with the security of investing alongside a government-backed fund.

In its first year or so of operations, RDIF has made investments in the stock exchange, power, medical and entertainment sectors in Russia, and has entered into investment co-operation agreements with Middle Eastern, Chinese and Indian sovereign backed investors, and with a consortium of leading financial institutions to provide pre-IPO support to Russian companies planning to list on the Moscow stock exchange MICEX-RTS.

## China undergoes leadership transition

**by Terence Foo, M&A Partner (Beijing)**

The 18th National Congress of the Communist Party of China held in November marked the start of the Chinese leadership transition with Xi Jinping and Li Keqiang to formally assume power next March. The run-up to the 18th Party Congress saw tightened public security and censorship in China, but also heightened deal uncertainty as government officials were more reticent, amidst the political jostling, to grant approvals for high profile M&A deals involving foreign acquirers.

Our general observation is that inbound M&A transactions that only require approvals at the provincial level (i.e. below central government level) are still managing to obtain approvals relatively smoothly. Deals that require approvals at the central level are taking longer. However, we expect deal certainty to improve in the coming months.

Time will tell what specific economic reforms will be put in place by the new leadership, but there are indications that the course of reform of China's economy will continue, although through incremental rather than sweeping reforms.

One of the major challenges facing the new leadership will be to manage the shift in China's economy from investment-led growth to consumption-led growth. One of the drivers of this growth will be increased urbanisation which should create opportunities for investors in sectors such as infrastructure, construction, pharmaceuticals and retail, as well as consumption related services such as logistics, healthcare, education and financial services.

# FIG M&A – Global perspective

**by Patrick Sarch, M&A Partner and Co-head Global Banks Sector Team**

Capital constraints, a tough economic environment in the UK and the Eurozone, as well as ongoing regulatory change, are the factors currently driving FIG M&A. European institutions are streamlining and disposing of non-core businesses, and we anticipate the market will be active through 2013.

"Financial services de-globalisation" is taking place, as international players, particularly European institutions, sell to local players in an effort to improve balance sheets, dispose of franchises and exit from riskier emerging markets. Asian assets are attracting a lot of interest, for example the sale of the Hong Kong, Macau and Thailand insurance units of ING Groep N.V to Pacific Century (a Hong Kong company) and the sale of ING's Malasia-based arm to AIA Group (the listed Hong Kong financial services group).

The biggest deals in the sector last year came from Asia (e.g. Japan's Sumitomo Mitsui Financial Group's US$ 7bn acquisition of RBS's aviation unit) and this trend looks set to continue in 2013.

We are also seeing increased activity in Africa which looks set to continue as foreign institutions seek exposure to the upwardly mobile consumer population there, with a particular focus on banks and credit card payment infrastructure businesses. In addition, Middle Eastern institutions are starting to show interest (albeit more limited) in acquiring local operations of European banks.

Another key trend is institutions moving away from manufacturing financial products towards a distribution-only model – e.g. the shift towards bancassurance deals (partnership between a bank and insurance company with aim of selling insurance products to the bank's client base). Also banks are disposing of their asset management businesses with ongoing distribution arrangements with buyers.

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### Cross-border M&A: Perspectives on a changing world

This is a multi-regional survey conducted in 2012 into how large corporates view the opportunities and risks to cross-border M&A. It reveals that emerging high-growth markets are the key focus for future growth and that companies are looking to navigate integration and deal execution risk through the use of alternative deal structures. Available through the Global M&A Toolkit at

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