

Market Intelligence

M&A
2020

Global interview panel led by
Simpson Thacher & Bartlett LLP

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Germany

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1 | What trends are you seeing in overall activity levels for mergers and acquisitions in your jurisdiction during the past year or so?

It was good to see that the German M&A market has been remarkably stable in 2019 and, perhaps contrary to some forecasts, overall deal activity with a German participant in 2019 was only slightly down compared to 2018. Inbound business has shown to be a reliable component of the German M&A market, with notable participation from private equity investors targeting German public companies, in some instances through club deals. In 2019, we saw that companies on occasion entered into joint venture and cooperation agreements rather than into M&A agreements. The first quarter of 2020 has been particularly fuelled by a number of larger ticket deals, such as Thyssenkrupp's €17.2 billion sale of its elevator business to a consortium led by Advent and Cinven.

With the covid-19 shutdown, deal activity in the second quarter slowed down severely, with the German economy officially entering into a recession in April 2020. At this time, the majority of the remaining deals had been placed on hold and in some cases completely abandoned. Since the beginning of the third quarter, we observed several sizeable value deals returning, some of them with a German participant, such as the announcement by Siemens Healthineers to take over Varian Medical Systems, Inc for US\$16.4 billion. With decent cash balances, borrowing interest rates continuing to be low and multiples likely to drop from the highs of recent years, we will hopefully see a healthy increase in M&A activity for the rest of the year, particularly in the mid-cap segment and outbound from larger German companies.

Still, the overall approach by potential buyers remains cautious. As already observed in the automotive sector in 2019, we will also continue to see more partnerships, joint venture agreements and pooling resources, rather than acquisitions.

2 | Which sectors have been particularly active or stagnant? What are the underlying reasons for these activity levels? What size are typical transactions?

The technology, healthcare and pharmaceutical sectors have been the driving forces of M&A activity in 2019. Private equity investors have stood behind a considerable number of these deals.

The covid-19 pandemic has resulted in a wave of consolidation, which will continue over the next few months, particularly in the transportation and logistics, fashion and retail, aviation, automotive supplier and leisure sectors, resulting in deal activity in these sectors for the remainder of the year. Industries that benefit



from the crisis and that will see increasing activity include the healthcare industry, in particular digital health and med-tech. FinTech will also see strong activity. In the real estate industry, an increase in demand for logistic centres and warehouses is partially driven by growth in e-commerce.

Looking ahead, we foresee intense competition among private equity investors for suitable investments, with targets also including German small and medium-sized companies in the IT, manufacturing, and med-tech and healthcare sectors. A recent example is the acquisition of the hygiene solutions provider Schülke & Mayr GmbH by EQT in August 2020.

3 | What were the recent keynote deals? What made them so significant?

In the race to market for a covid-19 vaccine, German biotech CureVac AG has received considerable interest from both public and private investors. The German government acquired a stake for €300 million in June 2020. In July 2020, the British pharmaceutical company GlaxoSmithKline agreed to a €150 million equity investment in CureVac and the Qatar Investment Authority signed up to a €110 million

“There seems to be a renaissance of earn-out structures in an effort to bridge valuation gaps and pricing uncertainties caused by the ongoing covid-19 crisis.”

equity investment. In August 2020, CureVac was listed on the US stock exchange NASDAQ, raising an additional US\$250 million, of which US\$150 million is to be invested in research and development.

The fight for the takeover of Munich-based Osram Licht AG in July 2020 was eventually won by Austrian sensor maker AMS AG with a purchase price of approximately €2.7 billion. AMS has been fending off a consortium between Bain Capital and Carlyle, the transaction can in principle be seen as sign for a continuation of club deals. In the transatlantic context, two high-value German-led strategic acquisitions of US corporations stand out:

- the US\$10 billion acquisition of Cypress Semiconductor Corporation by Infineon Technologies AG in April 2020, which is underlining the consolidation trend in the global chip industry; and
- the announcement of Siemens Healthineers AG's acquisition of Varian Medical Systems, Inc at a purchase price of US\$16.4 billion.

The €6.8 billion acquisition of the US brake company WABCO by Germany-based automotive supplier ZF Friedrichshafen AG is an example of a major cross-border acquisition in the automotive sector that has closed after being signed prior to the covid-19 pandemic.

4 | In your experience, what consideration do shareholders in a target tend to prefer? Are mergers and acquisitions in your jurisdiction primarily cash or share transactions? Are shareholders generally willing to accept shares issued by a foreign acquirer?

In German private M&A, we rarely see sellers accept anything other than cash consideration. While the total cash payment is occasionally paid in full on closing, you more frequently see deferred payment schemes, including escrows and hold-backs. There also seems to be a renaissance of earn-out structures in an effort to bridge valuation gaps and pricing uncertainties caused by the ongoing covid-19 crisis. If shares form part of the consideration, we find that this is driven by unique circumstances, such as the desire to put in place a joint venture-type structure.

From time to time, we come across stock-for-stock transactions in the public M&A arena. An exchange of shares in public companies is generally more attractive than an exchange of shares in closely held private companies. In Germany, the shares offered as consideration in a public takeover offer must be liquid securities admitted to trading on a regulated market in any European Economic Area member state. While offering shares issued by a foreign bidder can help navigate the risks of a shareholder challenge under German stock corporation law, this raises rather



complex issues of legal equivalence between the foreign offer shares and the German target shares. Since the beginning of 2019, we are aware of three public M&A transactions, which have been conducted by foreign bidders in the form of stock-for-stock acquisitions. We have acted for one of the bidders, ZEAL Network SE, a European stock corporation then governed by English law, when it successfully offered its shares listed on the London stock exchange by way of exchange for the shares in German Lotto24 AG.

5 | How has the legal and regulatory landscape for mergers and acquisitions changed during the past few years in your jurisdiction?

We have recently seen some elements of uncertainty creep into the legal and regulatory landscape for M&A in Germany. A general issue that has already received attention by deal parties over the past few years is the increase of compliance regulations (anti-bribery, anti-money laundering, sanctions and privacy and cybersecurity, especially after the General Data Protection Regulation (GDPR) came into

force), which continues to be of importance. This should be kept in mind for diligence purposes and when drafting a sale and purchase agreement.

A change at the beginning of 2020 with implications for public M&A was the amendment of the German Securities Acquisition and Takeover Act, under which it is no longer possible to circumvent the blocking period of one year for a new takeover bid. Previously, a bidder could use a person acting in concert to submit a new takeover bid after the initial offer had failed. This was a loophole used by Deutsche Balaton Aktiengesellschaft in their bid for Biofrontera AG and then, prominently, by AMS AG in their recent public takeover of Osram Licht AG. A development affecting German private M&A is a decision by the German Federal Court of Justice confirming that shareholders in a German limited liability company must adopt a shareholders' resolution to approve the sale of its entire or quasi-entire assets, while, at the same time, dismissing a widely held view that the sale will always be void if the shareholders ultimately fail to give their approval.

Over the past few years, we have also seen a number of 'enhancements' to Germany's foreign direct investment control regime. Most recently, acquisitions of at least 10 per cent in German companies that develop, manufacture or produce vaccines, drugs, protective equipment or other medical goods for the treatment of highly infectious diseases will be required to be notified without undue delay to the German Federal Ministry for Economic Affairs and Energy. As previously mentioned, there are several German companies that continue to make good progress in developing a covid-19 vaccine and in which foreign investors were interested in acquiring stakes. On the competition law end, and in the context of covid-19, the German Federal Cartel Office has recently sent a comfort letter to the German Association of the Automotive Industry endorsing a model process for individual restructurings and conditions for coordinated production restarts. This should reassure participating companies that their measures, if conducted along the lines of the comfort letter, will not expose them to significant risks under antitrust law in Germany.

6 | Describe recent developments in the commercial landscape. Are buyers from outside your jurisdiction common?

Germany continues to be considered an extremely attractive jurisdiction for foreign direct investment. The country's strengths traditionally include a powerful and diversified industrial network, a highly skilled workforce with a good command of English, reliable infrastructure, a favourable social climate, a strategic location at the heart of Europe and a stable legal framework. As a result, German companies in cross-border acquisitions have been favoured targets for foreign investors, both on

the strategic and the financial sponsor front. Against the background of uncertainty caused by Brexit, US tax reforms, a tight labour market and a stagnation in the automotive industry, the inflow of foreign direct investment into Germany in 2019 somewhat decreased. It will not come as a surprise that, as a result of the covid-19 crisis, cross-border M&A diminished by more than 50 per cent in the second quarter of 2020 compared to the second quarter of 2019. As in other countries, new investments, as well as existing investment projects, have been impeded by global lockdowns, disruption in global supply chains and considerably enhanced restrictions in global foreign direct investment control regulations.

As a result, we have, for example, seen few inbound transactions from China. This decline is not only the result of covid-19, but has come about for a number of reasons including the ongoing trade war and Chinese currency export restrictions. In contrast, the interest of Japanese investment in German companies has picked up over the past couple years. We have seen a number of Japanese corporations either make initial investments in Germany, add-on acquisitions and corporate reorganisations of their entire European businesses. The bulk of the M&A investments in Germany, however, still come from the United States, the United Kingdom, the Netherlands and Luxembourg. Other significant players in German inbound M&A come from Switzerland, France, Italy, Belgium, Austria, Spain and Denmark.

We are now seeing a slow, but steady, uptick in the interests of foreign buyers in German companies. With some German industrials strategically focusing on their core business, there will be, for example, plenty of opportunities for carve-out transactions. This will be an interesting field for both foreign strategic buyers and private equity.

7 | Are shareholder activists part of the corporate scene? How have they influenced M&A?

Recently, there have been a number of high-profile cases of shareholder activism in Germany, including Thyssenkrupp AG divesting its elevator business upon initiatives taken by the hedge funds Cevian Capital and Elliott Management Corporation and Active Ownership Capital initiating the restructuring of Stada Arzneimittel Aktiengesellschaft. As in many other jurisdictions, shareholder activism currently plays a certain role in Germany's corporate scene, even though German-listed companies are traditionally better protected against shareholder activism than international companies by often having decisive shareholders and relatively low free float. Activists exert influence with regard to M&A matters in several respects, such as in connection with public takeovers when activists buy shares with a view of forcing the bidder to raise the offer price, a method used by Elliott in the context

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of Vodafone's public takeover offer for the shares in Kabel Deutschland AG. In other cases, activist investors push for specific acquisitions or divestitures of business lines of the listed companies in which they hold stakes. The newly permitted virtual general meetings may slightly curtail possibilities in Germany to take influence.

8 | Take us through the typical stages of a transaction in your jurisdiction.

The phases of an M&A transaction in Germany largely conform to Anglo-American standards. More or less everyone on the ground in Germany is comfortable with negotiating and documenting cross-border deals in English. In a bilateral deal, the parties frequently communicate with each other directly. Depending on the deal volume and company size this can happen at all levels, including board level or the level of the internal business development teams. Financial advisers sometimes facilitate the initial contact and the overall process, especially when it comes to upper mid-cap or large M&A transactions. As a first legal document, the parties will typically execute a non-disclosure agreement. If the parties are competitors, we see an increasing trend to put in place clean team arrangements early on.

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While the parties frequently prefer to initially summarise key terms of the envisaged transaction in letters of intent, others immediately jump into the due diligence exercise and the negotiations of definitive agreements. By way of exception, we have also seen sales processes without any diligence review at all. This must be justified by the buyer's board on a case-by-case basis and include measuring any advantages and disadvantages by applying the business judgement rule. Due diligence is now, in most cases, managed through virtual data rooms and in larger international transactions, with thousands of contracts, buyers increasingly apply legal technology tools to be able to review the data efficiently.

The negotiation of the sale and purchase agreement often takes two to four rounds. However, we have also seen fast-track negotiations and negotiations that have dragged on for several months. In Germany, the first sell-side draft of the sale and purchase agreement tends to be a little less 'middle of the road' than you would usually expect from a US or UK perspective. Before a deal can be signed, it is the seller's job to prepare the disclosure schedules against the warranties – Germany's answer to England's disclosure letter. Originally used predominantly by private equity sellers, we are now seeing more and more strategic deals using warranty and indemnity (W&I) insurance. One German peculiarity is that the sale and purchase agreement must often be notarised, notably if the transaction involves the sale of shares in a limited liability company. Occasionally, foreign investors find it rather surprising that in a notarisation the documents must be entirely read by the notary in the presence of all of the parties' representatives. This exercise may take several hours or, at times, it may even end up being an overnighter if the deal has not been finalised in all respects prior to the notarial session. After signing, the parties will focus on all regulatory clearances, which have to be obtained prior to closing. Similar to other jurisdictions, the German foreign direct investment control regulations have recently been enhanced. The practical significance of any foreign direct investment control clearance should, in these days of rising national protectionism, not be underestimated by investors from outside the European Union.

In an auction, a process letter will be provided with procedural guidance to all bidders. In preparation for auctions, German sellers often conduct a vendor due diligence review to provide all bidders up front with at least basic legal, tax and financial information on the target. Following the due diligence review – and sometimes subject to confirmatory due diligence – the bidders are asked to submit final bids including a statement of the value they place on the equity and a mark-up of the sale and purchase agreement. Additionally, in German auctions, we frequently see 'seller-buyer flip' W&I insurance, where the seller begins to arrange for insurance with the preferred buyer at some point in the process then stepping into the shoes of the seller to finalise the underwriting.

Public M&A transactions in Germany are, like in other jurisdictions, much more regulated than negotiated deals. It is customary to carry out substantially less due diligence. Notice periods and the prescribed contents of the offer document are set out in the German Securities Acquisition and Takeover Act.

9 | Are there any legal or commercial changes anticipated in the near future that will materially affect practice or activity in your jurisdiction?

We anticipate some further market changes induced by covid-19. We are already seeing an increase in distressed M&A in sectors hard hit by the pandemic. In addition, investment control and competition law stand out as bringing legal changes with a significant impact on M&A. Under the new EU Investment Screening Regulation, member states are required to cooperate on foreign investment control review proceedings and exchange relevant information. The European Commission will have the right to issue non-binding opinions and to encourage member states to review specific transactions, while not having independent jurisdiction comparable to the Committee on Foreign Investment in the United States.

Germany, in implementing the EU regulation, will extend the list of critical technologies triggering a mandatory filing to artificial intelligence, biotechnology, semiconductors and quantum mechanics. Pending regulatory clearance of a transaction, an investor is prohibited from implementing the deal (jumping the gun) through exercising voting rights in the target, having rights in the target's profits or economical equivalents or obtaining sensitive information relating to the target. Violations of these prohibitions are subject to fines and criminal penalties, which means that consummation of transactions will have to be made subject to foreign investment control clearance. The threshold for prohibitions of foreign investments has been lowered such that the authorities need no longer identify a concrete and severe risk to public order or security of another EU member state or Germany's essential security interests for investments in the defence sector. A potential negative effect will be enough. Finally, the timing for review has been shortened to two months to open a formal investigation after becoming aware of the transaction and four months to prohibit or impose conditions on the investment. If necessary, these timelines can be extended.

Significant changes to German competition law are around the corner as part of a government draft reform bill to German competition law. Changes include an increase of relevant thresholds, with the second domestic turnover threshold raised from €5 million to €10 million. The de minimis threshold will move up from €15 million to €20 million. It will also have to be assessed on a combined market basis rather than on a single-market basis and will require calculations based on internationally recognised accounting standards such as the International Financial Reporting Standards. The



maximum duration of the Phase 2 review period will be extended from four to five months. Obtaining ministerial approval for a transaction will, in future, require prior court confirmation of the Federal Cartel Office's competitive assessment.

Another noteworthy point influenced by the covid-19 emergency is that 'over-indebtedness' as a separate trigger for the duty to file for insolvency may be abolished in the near future, aligning Germany in this respect with Anglo-American jurisdictions. Already under the covid-19 emergency legislation over-indebtedness will likely continue for some time and be suspended as a trigger for the duty to file for insolvency.

10 | What does the future hold? What activity levels do you expect for the next year? Which sectors will be the most active? Do you foresee any particular geopolitical or macroeconomic developments that will affect deal sizes and activity?

As a consequence of covid-19, we, as part of the global M&A community, have entered into one of the most uncertain periods of our careers. This is a rather unpleasant experience and is worsened by additional uncertainty arising from any hard Brexit,

the lack of progress in the EU–UK trade talks, the upcoming US elections and a global trend for protection from unwanted foreign direct investment. There are other developments such as an increase in shareholder activism that can negatively impact whether or not a public deal is likely to go through in the future.

At the same time, we continue to experience megatrends such as increasing digitisation, electrification and globalisation. We expect these trends not only to be drivers for a quick bounceback of the economy, but also for a rebound of M&A activity levels. Further, let us not forget we continue to have extremely cheap money and plenty of liquidity within the market, which needs to be invested. Financial sponsors will help invigorate M&A. Sponsor-backed companies are currently still in a waiting mode and unable to exit, but we expect exits to return to the scene sometime in the fourth quarter of 2020. In Germany, M&A will continue to benefit from the unique characteristics of family-owned, small and medium-sized companies seeking investors due to succession issues. Also, on the part of multinational corporations, we will likely see an increase of carve-out transactions. At the same time, acquisitions will continue to be a key growth strategy for larger corporations. Finally, but importantly, we will see a sharp increase of deals in the distressed category, if and when the German suspension of the duty to file for insolvency is expiring.

In terms of sectors we expect that technology, healthcare and med-tech will see higher acquisition activity. In contrast, banks, travel, automotive and retail will be under pressure and subject to consolidation, which means that smaller businesses may have a hard time in the next year or so. We will have to wait for the US elections to see how M&A in the regulated industries like energy, telecoms and pharmaceuticals will develop in the future.

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The Inside Track

What factors make mergers and acquisitions practice in your jurisdiction unique?

The formalities of German corporate law result in a number of practical restrictions, which are unknown in Anglo-Saxon jurisdictions. For example, it is sometimes required to use 'limitation language' to fit upstream loans into the requirements of German capital maintenance rules. Legal features integral to group structures, such as domination and profit pooling agreements, demand special provisions in sale and purchase agreements. In a nutshell, Germany has established a practice over the past couple of decades to combine Anglo-Saxon legal concepts with mandatory German corporate law.

What three things should a client consider when choosing counsel for a complex transaction in your jurisdiction?

When facing a complex M&A transaction, you should initially look for a truly cohesive external legal team with an experienced team lead who understands the commercial aims of the transaction and focuses on the key points. Secondly, the team should include expert lawyers with proven track records in the functional focus areas of the deal. Thirdly, you should bear in mind that one important task for counsel will be to stay on top of the international aspects of the deal.

What is the most interesting or unusual matter you have recently worked on, and why?

Acting for an international consortium of bidders in an auction for a private company held by a governmental entity under the rules and regulations of European public procurement law. Combining traditional corporate and M&A issues with issues of large government contracts, public concessions and public procurement presented for the large cross-practice team a unique set of challenges in the auction process and the negotiations.

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