

CLEARY GOTTlieb

German M&A Report



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Another Banner Year for Mergers and Acquisitions in Germany

Following the international record set in 2015, the M&A market in 2016 has proven to be robust.

External influences such as the Brexit referendum in early summer and the U.S. presidential election in November did in fact have an impact, but the M&A market has held its own despite the apprehension on several fronts. In particular, the announced Bayer/Monsanto transaction caught the attention of market participants worldwide. Even though this was the largest foreign investment by a German company, it was just one deal in an eventful year for M&A in Germany.



Outbound Deals: The U.S. in the Limelight

An already established ongoing trend continued in 2016, with major foreign investments by German companies targeting the United States. At a transaction volume of around US\$66 billion, Bayer's acquisition of Monsanto decidedly out-did the US\$43 billion takeover of Chrysler by Daimler, until then the largest German foreign investment. The Leverkusen group did, however, only succeed in convincing the U.S. agricultural company of the attractiveness of the improved offer following long, drawn-out and tactical negotiations.

With the Voicestream acquisition by Deutsche Telekom for around US\$27.1 billion, Merck's acquisition of Sigma-Aldrich for around US\$16.4 billion and the acquisition of the OTC business of the U.S. company Merck & Co. for around US\$14.2 billion, again by Bayer, four further transactions involving U.S. target companies can be found on the list of the 10 largest foreign investments by German companies to date.

Beside the Monsanto acquisition, yet another series of key transactions originating from Germany were announced in 2016 with U.S. target companies. The takeovers of Mentor Graphics by Siemens, Air Products by Evonik, Sun Products by Henkel, Dematic by Kion and Chemtura by Lanxess had transaction volumes in the area of well around US\$2.5 billion up to some US\$4.5 billion, thus contributing decisively to German M&A activities.

If the merger of Praxair and Linde goes through after all, first having been canceled but now under discussion again, it would rank ahead of the Chrysler acquisition by Daimler with a transaction volume totaling some US\$60 billion. Whether this actually qualifies as an outbound investment is debatable, however.

The recently announced acquisition of a 75 percent holding of the 3D-printer engineering firm Concept Laser by GE for around €550 million and the first German investment by Tesla, the acquisition of plant manufacturer Grohmann, are just two current examples of the fact that, U.S. investments in Germany continue to play a key role for the German M&A market.





Inbound Deals: China Takes Center Stage

Investors from China particularly stood out in connection with foreign investments in Germany. German companies were their favorite targets in 2016 in Europe. In this regard the acquisition of the robot builder Kuka by the Chinese manufacturer of electronic devices Midea, at a transaction volume of around €4.6 billion, has been the largest Chinese direct investment in Germany to date. In a competitive bidding procedure involving several potential Chinese buyers, Beijing Enterprises succeeded in securing EEW Energy from Waste with a bid in the amount of around €1.44 billion.

Further examples of the significance of Chinese investors for the German M&A market include the acquisition of the engineering firm KrausMaffei by ChemChina for around €1 billion and the acquisition of the water technology business of Bilfinger by Chengdu Techcent Environment for around €200 million.

The role played by Chinese investors has markedly increased over the last several years. The industry focus has now broadened, shifting toward tech companies, while Chinese investors a few years ago were still concentrating on the acquisition of automobile suppliers and solar energy companies in crisis. Transaction volumes have also shot up significantly, and the structure of transactions has become decidedly more complex.

A turning point can be seen in the entry of Weichai Power into Kion, which at the time created new benchmarks in terms of volume and complexity. Further, at first potential Chinese buyers had a poor reputation in divestment deals due to the numerous approval requirements and lack of transparency, but with the EEW Energy From Waste acquisition by Beijing Enterprises, they now seem to be fully accepted on the German M&A market. Competition between several potential Chinese buyers for the same foreign target company was no longer prohibited by China.

In this regard, however, the trust created on the market was crushed by the back-out of the successful Chinese bidder for the Hahn airport. At year end it was also announced that the Chinese State intends to curb foreign investments again. Any investments having a volume of over US\$10 billion are expected to be prohibited in general. Acquisitions outside of core business with a volume of over US\$1 billion would then also be ruled out by law. Such plans by the Chinese government have yet to be officially confirmed; it also remains unclear whether the avoidance of capital drainage into foreign countries forms the only basis for their motivation.



Active Industry Policy

In 2016 Chinese investors also reignited the heated debates surrounding more active German and European industry policies. Midea's takeover bid for the robot builder Kuka triggered intense discussions about the dangers of "rummaging" German high-tech. According to press reports, the German Federal Ministry of Economics even sought competing offers from German or European investors — ultimately without success.

The transaction did, however, give rise to renewing the discussion regarding an intense examination of investments by non-European market participants, with a key issues paper being submitted at the EU level by the Federal Ministry of Economics. In some instances the European Commission considered a European Foreign Trade Act. Coinciding with this, the Federal Ministry of Economics revoked a previously issued clearance certificate for the planned acquisition of the

chip plant manufacturer Aixtron by the Chinese Grand Chip Investment; new information had been submitted from the U.S. on a potential military use of the company's products. While the more thorough-going inquiry by the Federal Ministry of Economics proceeded, the U.S. prohibited the transaction in view of Aixtron's U.S. subsidiaries and assets. Grand Chip Investment then declared the bid expired. In the meantime, the Federal Minister of Economics signaled its understanding to the staff of Osram for rejecting the anticipated takeover by a Chinese investor.

The latest plans of the Chinese government to limit outbound investments might in part make such approaches to industry policy obsolete. On the other hand, it is not unlikely that this topic will be taken up again in the upcoming election year and that industry policy will become a campaign topic.

Other Trends

Apart from these developments, other trends impacting the German M&A market also emerged in 2016.

After Bayer had successfully placed Bayer's MaterialScience division on the stock market last year under the name Covestro, RWE and E.ON followed suit this year with the carve-out and placement of innogy and Uniper. In the second half of the year, Siemens announced potentially bringing its medical technology division to the stock market, with a corporate value on the order of around €30 billion being reported.

The success of this transaction type is having an effect on M&A activities. Various financial investors had a sustained interest in Covestro but finally lost out against the IPO. In the past, such decisions by the parent company frequently still had a different outcome. A similar development, again unfavorable to a sale, would not be surprising in the case of the Siemens medical technology division.

In M&A transactions involving financial investors, the large number of secondaries stood out, where a portfolio company is passed on from one financial investor to the next. Transactions of this type are assumed to account in all for half of the deals in 2016. The drivers for this include the unrelenting investment pressure on financial investors given the modest number of suitable target companies, but it is also due to the difficult market conditions for exit IPOs. Further, frequently the managers of holding companies have now also

learned to appreciate the holding strategies pursued by financial investors, often preferring these to a corporate group structure. In effect, strategic investors often do not have a chance to get into the game.

Finally, 2016 will also be known as the year that U.S.-style shareholder activism took hold in Germany. The battle for control of the pharmaceutical company Stada demonstrates how far shareholder activists are willing to go even in Germany. Despite the limited channels available under German law for shareholders to influence the management, just minority shareholdings can create sizable, even if only indirect, pressure on the board. The role that activist shareholders can play on the M&A market is demonstrated rather well by the example of the various sales of business divisions of the traditional Bilfinger company. This role cannot be expected to dwindle in the future.

Outlook

Despite the uncertainty surrounding the Brexit referendum as well as before and after the presidential election in the U.S., the German M&A market showed its strength again in 2016, and with the Monsanto acquisition announced by Bayer produced the largest foreign investment by a German company to date.

There are still no signs of the German M&A market slackening off in the U.S. Five of the 10 largest foreign investments by a German company to date targeted U.S. companies, and investments from the U.S. targeting German companies have always been crucial for the German M&A market. The situation is different, however, in regard to transactions involving Great Britain. Even just the discussions taking place about the upcoming negotiations of the withdrawal of the UK from the EU are influencing the climate for M&A

transactions related to the region. Until the course that Brexit will take becomes clear, increasing hesitation on the part of market participants is to be expected.

The role to be played by Chinese investors on the German M&A market in 2017 depends largely on industry policy decisions in their home country and on the decision for or against a more active industry policy in Germany and in Europe.

Nonetheless, Germany can look forward to an active M&A market in 2017, especially given the continuing strength of the national M&A market in the key mid-market segment, and in particular the continued attractiveness of transactions involving the U.S.

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