M&A REPORT

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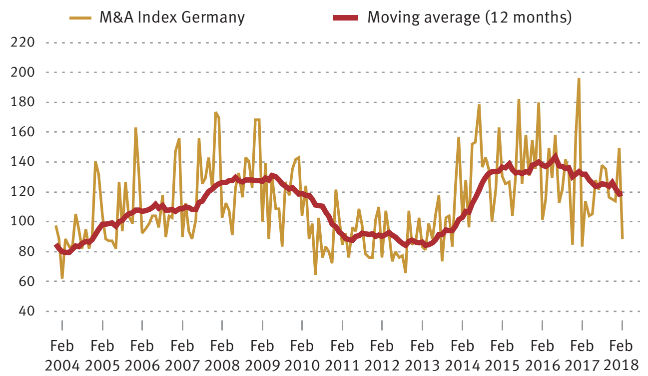
M&A REPORT

Number of Mergers and Acquisitions Involving German Firms Continues to Fall

The number of mergers and acquisitions (M&As) involving German companies has continued to fall in recent months, albeit not as sharply as last year. The first quarter of 2017 had been unusually weak, though M&A activity stabilised and remained moderate in the second half of the year. This was reflected in the ZEW-ZEPHYR M&A Index, which is published every six months. Although the highest ever single-month index value of 196 points was recorded in January 2017, the twelve-month average has been exhibiting a downward trend since June 2016, and last stood at 119 points. Strong M&A activity in January 2018, which saw the M&A Index rise to 149 index points, nonetheless helped to slow this downward trend.

ZEW-ZEPHYR M&A INDEX GERMANY



Source: Zephyr database, Bureau van Dijk, calculations by ZEW

Unlike the number of transactions, transaction volumes have increased in the past six months. This was primarily due to three megadeals with volumes of over a billion euros each. The largest of these deals was Deere & Company's 4.3 billion-euro acquisition of the German Wirtgen Group, a privately-held international company which produces road construction machinery, at the end of 2017. With this acquisition, the US company is set to become a significant player in the road construction market.

A further deal which received great public attention was the acquisition of Oetker Group's shipping division Hamburg Südamerikanische Dampfschifffahrts-Gesellschaft KG (Hamburg Süd) by its Danish competitor, Maersk Line. After owning the German container line for more than 50 years, the Oetker Group sold Hamburg Süd for approximately 3.7 billion euros at the end of 2017. The acquisition further continues the trend towards consolidation in the container shipping sector, where the five largest companies now account for more than 60 per cent of market capacity.

Finally, the Bremer Kreditbank acquired the private bank Oldenburgische Landesbank for 300 million euros from German insurance giant Allianz at the beginning of this year. This sale signals the end of Allianz's ambitions to establish an "Allianzbank". By contrast, it will allow Bremer Kreditbank's sole owner, the American financial investment firm Apollo, to strengthen its position in Germany. In the northern part of the country, many banks are feeling the effects of significant losses in the shipping industry, which has spurred speculation that Apollo may also seek to acquire the ailing HSH Nordbank.

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The **ZEW-ZEPHYR M&A-Index** measures the number of M&A transactions completed in Germany each month. It considers only mergers and acquisitions by and with German companies. It does not differentiate between the country of origin of the buyer or partner. This means that both domestic and international buyer companies are considered, provided that the target companies are active in Germany.

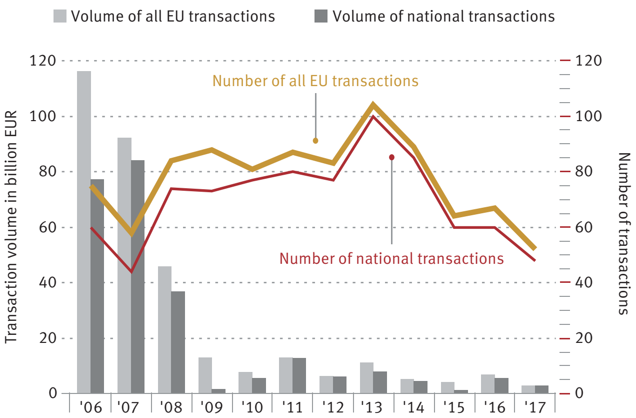
BUREAU VAN DIJK

The M&A Report is a biannual publication issued by ZEW and Bureau van Dijk. It uses the Zephyr database to report current topics and developments in global mergers and acquisitions. The Zephyr database, which is updated on a daily basis, contains detailed information on over 1.7 million mergers and acquisitions, IPOs, and private equity transactions around the world.

Sluggish M&A Activity to Foster Fragmentation in the EU Banking Sector

Since 2009, M&A activity in the European banking sector has stagnated at well below pre-financial crisis levels. While M&A transactions totalled 116 billion euros in 2006 and 91 billion euros in 2007, transaction volumes plummeted in the wake of the Lehman crisis, reaching a mere three billion euros in 2017. The majority of transactions now take place at the national level and predominantly between smaller, regional banks. International transactions at the EU level, meanwhile, have come to an almost complete standstill; since 2010, they have accounted for less than ten per cent of all M&As per annum, compared with 25 per cent in 2007.

M&A ACTIVITY IN THE EU BANKING SECTOR



Source: Zephyr database, Bureau van Dijk, calculations by ZEW

The low M&A activity has contributed to the fragmentation of the European banking sector along national lines. Even large banks tend to focus their activities in domestic markets and only enjoy a limited presence in other EU countries. This has not only impacted on efficiency; in adversely affecting capital flows and the distribution of macro-economic risks between EU countries, it has also inhibited the functioning of the European Single Market. Regulators are therefore increasingly encouraging European banks to engage in cross-border M&As – albeit with little success so far.

Regulatory impediments to M&A activities

Cross-border M&A activity is hampered by the lack of integrated regulatory and supervisory structures at the EU level. While the Banking Union and the introduction of the Single Rulebook are important steps towards simplifying transnational banking and establishing a unified banking market, national regulatory and supervisory differences nonetheless remain between the various EU countries. Furthermore, the ambiguity of the new EU regulations on the unwinding of multinational banks, the lack of a Europe-wide deposit guarantee scheme, and national differences in insolvency law have led investors to be cautious about potential acquisitions.

At present, a significant number of banks are undergoing restructuring processes. In light of contemporary challenges in the sector, many are focussing their efforts on digitalisation and developing organic growth strategies that eschew complex business models. Furthermore, transnational M&As involve significant costs, without necessarily generating exceptional synergies. And last but not least, linguistic and cultural barriers may also contribute to inhibiting transnational endeavours.

In sum, an upturn in M&A activity in the EU banking sector seems unlikely in the near future, and the introduction of the Banking Union and the low profitability of the sector will do little to change this in the short term.

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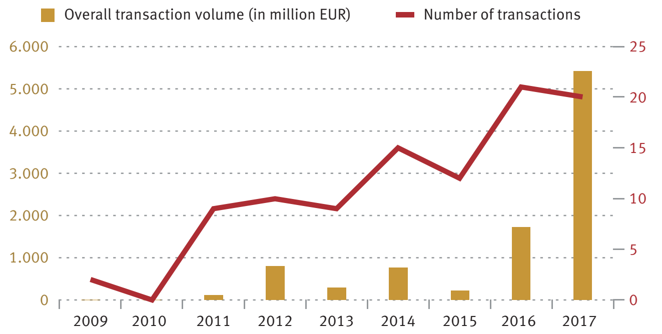
China Increasingly Investing in German Firms

Chinese investors are becoming increasingly interested in German technologies, and have been buying German companies with high-tech expertise for a good two years now. Investors have shown particular interest in the small to medium-sized technology firms often referred to as “hidden champions”. The 3.7 billion euro acquisition of the robot maker KUKA, for example, garnered particular media attention. The number of Chinese acquisitions reached 21 in 2016 and 20 in 2017 – a tenfold increase over the 2009 figures. In 2017, China was ninth on the list of countries investing in German companies. The top spots were occupied by the USA, Switzerland, and France, with 83, 41, and 40 acquisitions, respectively. In the medium term, China may well come to join these front runners.

It was not only the number of Chinese acquisitions that rose to record levels in the past two years, but also their volume, which peaked at a record sum of more than five billion euros in

NUMBER AND VOLUME OF CHINESE M&A TRANSACTIONS IN GERMANY



Source: Zephyr database, Bureau van Dijk, calculations by ZEW

2017. While China was responsible for only five per cent of foreign acquisitions of German firms in 2017, it accounted for almost 21 per cent of total acquisition volume. The fact that all of the largest Chinese acquisitions were in the technology sector highlights China's shift towards a more innovation-oriented economy. These acquisitions included ZF Friedrichshafen's Body Control Systems division, the lighting manufacturer Ledvance GmbH, the assembly systems supplier Preh IMA, and the cleaning technologies firm Dürr Ecoclean.

This trend seems to be continuing, since three German automobile parts suppliers were sold to Chinese investors in January and February 2018 alone. Rumours surrounding the acquisition of clothing firm C&A, however, indicate that China's interest is not restricted to the technology sector.

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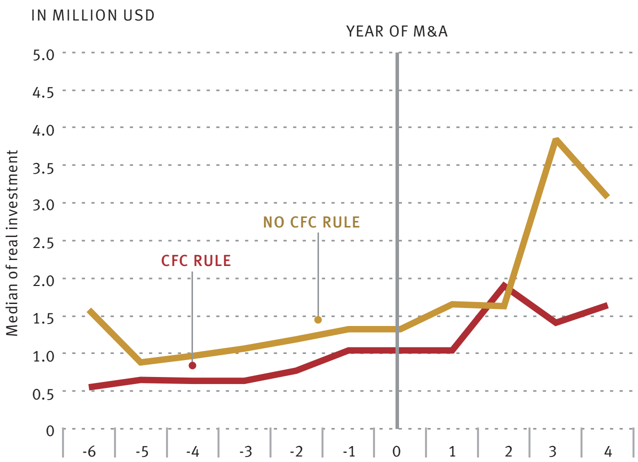
Tax Avoidance Rules Reduce Investment Following Mergers and Acquisitions

Transnational mergers and acquisitions are an important form of foreign direct investment (FDI). In 2016, for example, around 52 per cent of global FDI took the form of transnational M&As. When a company in a high-tax country is acquired by a multinational group, it may seek to reduce its capital costs by shifting its post-acquisition profits to affiliated companies in low-tax countries.

National governments have nonetheless sought to prevent such profit shifting through tax avoidance regulation, including controlled foreign corporation (CFC) rules. These rules require the profits of affiliated companies in low-tax countries to be immediately taxed in the country where the multinational group has its headquarters. This significantly reduces profit shifting opportunities for multinationals based in countries with effective CFC rules.

A recent ZEW study investigated changes in investment in tangible assets ("real investment") and in financial performance and profit levels in companies acquired by multinational groups. The study contrasted multinationals headquartered in countries with CFC rules and those located in countries without such rules.

DEVELOPMENT OF REAL INVESTMENT BEFORE AND AFTER ACQUISITIONS IN HIGH-TAX COUNTRIES



Source: Zephyr database, Bureau van Dijk, calculations by ZEW

Post-M&A investment rises in companies based in high-tax countries

The results suggest that real investment in companies in high-tax countries rises following their acquisition by a multinational group headquartered in a country without CFC rules. The same effect was not observed among companies in low-tax countries.

The study compares the effect of acquisitions on real investment in those countries with the lowest and highest corporate tax rates (12.5 per cent and 38.9 per cent, respectively). Among companies in low-tax countries, the researchers observed a 48 per cent reduction in post-acquisition real investment, compared with a 33 per cent rise among companies in high-tax countries. The latter effect was nonetheless only observed for multinationals headquartered in countries without CFC rules. Real investment in transnationally acquired companies would therefore seem to depend on whether CFC rules are in place where the buyer is headquartered.

The complete version of the study can be downloaded at: *http://ftp.zew.de/pub/zew-docs/dp/dp17062.pdf*

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