Keeping M&A Afloat in France

While currency and interest rates are fueling M&A deal flow in France, unhelpful laws make it a struggle to stay buoyant.

By Howard Stock

Despite attractive financing conditions brought about as a result of a strong dollar relative to the euro as well as near-zero interest rates, the slowdown in French mergers and acquisitions (M&A) market activities over the past semester have had a negative effect on investor confidence. Indeed, during the first semester, French M&A volume was down by nearly 44%.

However, the French M&A market has been active this year, in spite of a low domestic economic growth, argues Jean-Nicolas Soret, a partner at ALTANA. "Although M&A is generally more active when growth is strong, this paradox shows that M&A opportunities can in fact arise in any economic situation," he says. "Many investors believe that they have been waiting for too long. They are now anxious to invest and they have the financial means to do so."

When faced with a slowdown in activity, the French market usually finds innovative ways to keep ticking along and tends to be driven by new trends, including most recently the trend of privatization of infrastructure assets, such as the French airports at Toulouse, Lyon and Nice, which was facilitated with the law for growth, activity and equality of economic opportunity, also called Loi Macron, says Julien Aucomte, partner at August & Debouzy. "The French market is even more correlated to companies' governance rules [than economic conditions], he says. "For instance, rules related to the management, as management package [i.e. more stringent corporate governance], attract more investors. Over the past few months, the trend has been very good and August & Debouzy is involved in a significant number of transactions, both on the seller and buyer side. We are confident that this situation will last the next few months."

Despite a slow start to the year, "foreign investors have shown interest in investing in France," says Nathalie Younan, partner at FTPA. "This had an impact on the valuation multiples which have progressively increased" as the year progressed.

That said, the hangover from the global recession that began in 2007-2008 perpetuates. In France, in addition to (and because of) a difficult economic environment, the past few years have been marked by the promulgation of new laws that have not helped to create the level of trust that is necessary to encourage the M&A activity in France, in particular as far as foreign investors are concerned, adds Aucomte. "For example, tax laws have increased the taxation on capital gains or some corporate or employment laws have created new obligations to companies." One such law is the Loi Hamon, which imposes before any sale of a company or an interest in a company that the employees of that company get first priority if they decide to buy out the company themselves, which plays havoc not only with the sensitive negotiations that go into crafting such deals, but also allows employee groups to put forth a low-ball offer with reasonable chance of success, at the detriment of the company's stakeholders. It is a well-meaning—and certainly politically expedient—effort, but not one that makes the prospect for a foreign investor of buying a French company more attractive.

However, despite unhelpful efforts by policymakers undertaken to curry favor with a disgruntled populace, M&A has been boosted by favorable financing conditions: the interest rates offered by the financial institutions are still very low and equity and debt markets have been active, Soret says. For example, "Gerard Rameix, President of the French stock exchange regulator, said that volumes on the Euronext Paris stock exchange over the first eight months of 2015 have been 34.7% higher than during the same period of time in 2014," he says. Thanks to those favorable financing conditions, "a good number of initial public offerings (IPOs) have recently been successful in France, such as the IPO of Europcar on Euronext Paris, with more than €1 billion equity raised."

SIGNIFICANT TRANSACTIONS

One of the most significant transactions this year is the acquisition of Alcatel-Lucent by Nokia, for €14 billion. The takeover bid launched by XPO logistics on the pan-European, French-based logistics company Norbert Dentressangle for €2.17 billion was also significant, not least for its challenges. XPO Logistics, a U.S.-based company, is "much smaller than Norbert Dentressangle, which is publicly traded on Euronext Paris and London," Soret says. "This bid was successful insofar as it enabled XPO Logistics to acquire more than 85% of Norbert Dentressangle but XPO Logistics was hindered by U.S. investment fund Elliott, which acquired shares on the market in order to block the squeeze out of the minority shareholders. This transaction reveals the renewed appetite by U.S. investors for significant French targets and points to the fact that shareholder activism might become a more common and usual practice on the European continent" than it has been in the past.

As always, some sectors are proving more popular than others, and it can prove instructive just to analyze the sector types garnering the most attention. The Ernst & Young annual barometer on the attractiveness of the French market lists the three main sectors for 2015 in France as energy, digital and healthcare, although it also mentions business services, the automotive industry and the agro-food industry, and, according to Ernst & Young, France also remains the number-one destination in Europe for industrial investment.

> **"Although M&A is generally more active when growth is strong, M&A opportunities can in fact arise in any economic situation."**
>
> —JEAN-NICOLAS SORET, ALTANA

"Generally, innovation is a key driver for investment and France's ability to innovate is shown by the fact that its R&D spending has once again been very strong in 2014, according to Thomson Reuters, with $54.7 billion compared to $39.1 billion in the U.K.," Soret says. "This may be why seven French-headquartered entities are listed on the Thomson Reuters Top 100 Global Innovators 2014 ranking."

Anecdotally, Younan reports that the aerospace industry, the automotive industry and the renewable energies are high on investors' lists. Aucomte adds that the technology sector is in full expansion with high growth potential based on the progress of communication and information processing and sharing. "The daily use of new technologies created a new large and attractive market and it contributed to the dynamism of the French market," he says. "For example, August & Debouzy assisted Orange for the sale of the online video-sharing website Dailymotion to Vivendi this last summer."

Further, the healthcare sector is also one of the most attracting sector due to important changes in lifestyle and to the development of health technologies and data management that facilitate diagnostics and treatments, Aucomte says. "Many investment funds understand the necessity to invest in the companies specialized in health and wellbeing," he says. "For example, August & Debouzy assisted Noveo in the context of the investment in a start-up called 7hugs, a company developing devices for the improvement of wellbeing."

JEAN-NICOLAS SORET
ALTANA

NATHALIE YOUNAN
FTPA

EAST MEETS WEST

The U.S. remains France's number-one investor, according to the Business France 2014 Annual Report, ahead of Germany (14%) and the U.K. (9%). However, investment is increasingly coming from Asia, and investors from China in particular have been quite active this year. "A good example in the hospitality industry is the acquisition of Groupe du Louvre by Chinese Jing

"The foreign exchange rates are more favorable to the U.S.-based players and this has been an incentive for these buyers to look at target companies in France."

—NATHALIE YOUNAN, FTPA

Jiang for €1.3 billion," Soret says. "Certain other transactions can be full of surprises, such as this acquisition of the Toulouse-Blagnac Airport by a consortium called Symbiose, 49.9% of which is held by Mike Poon, a wealthy Chinese citizen who used to also be the CEO of China Aircraft Leasing Company (CALC)…before he resigned and disappeared, being suspected of corruption in China."

Scandinavian countries, in particular Sweden, and Indian companies are also looking at targets in Europe, Younan adds, although she notes that "the foreign exchange rates are more favorable to the U.S.-based players and this has been an incentive for these buyers to look at target companies in France."

Indeed, "over the past few months, we have seen an increasing number of transactions led by foreign investors, in particular from the U.S.," Soret says. "The reason for this is that U.S. investors have cash available and are attracted by a more favorable USD/EUR exchange rate. For investors who generate all or most of their revenues in U.S. dollars, the current exchange rate creates opportunities for investment at better prices."

In terms of more lasting incentives, policymakers could do more to create an attractive environment for foreign investors, Younan says. "Regulators are not doing so much to facilitate the deal flow," she says. "However, in 2015 they tried to simplify certain rules and constraints in French employment law."

In lieu of any real reform, Business France, the French governmental agency dedicated to the promotion of inbound and outbound investment, has been actively trying to market two tax incentives known as "Crédit d'Impôt Recherché," an R&D tax credit, and "Crédit d'Impôt Compétitivité Emploi", a tax credit based on low salaries, as key elements put forward to attract foreign investors that will invest and hire in France, Soret says. However, the main elements of France's attractiveness to foreign investors remain the quality of education, with a skilled and imaginative workforce, and the quality of infrastructure, he says.

Nevertheless, the main obstacles to attracting foreign investment are still mainly related to French employment law in terms of information and consultation of the employees' representatives prior to any M&A transaction, Younan says. The Ernst & Young annual barometer on the attractiveness of France goes further, citing the cost of labor, administrative complexity and tax as the three main hindrances to an even more active M&A activity in France.

STICKING POINTS

"Among the three, the cost of labor and the lack of flexibility of the French labor market is probably the most stringent. Many investors are willing to create jobs but remain cautious just because they know it can be difficult and costly to reduce headcount if success is not as high as expected," Soret says. "France should therefore add flexibility to the labor market, instead of creating new constraints in the hope that unemployment might be lowered by offering more protection to the employees."

As things currently stand, though, the strong dollar remains one of the more significant drivers of new deals. For this reason, Younan is advising her non-U.S. clients to act swiftly in potential transactions. "Move as fast as possible because many competitors are U.S. companies and they are usually able to close deals very quickly," she says.

SUPPLY AND DEMAND

Younan expects the market will remain reasonably active if the foreign exchange rates remain at the same level. By the same token, demand may be starting to outstrip supply, especially now that political and economic stability in Europe has improved as the euro zone has found the way to avoid the Grexit. "Combined with a relative low value of the euro, this makes it a good time for foreign direct investment in Europe," Soret says. "Although prices have gone up and targets are not as cheap as they used to be, investment in Europe, and in France in particular, is a low-risk investment which may be attractive when the quality of assets is good."

Looking forward, Soret says he's optimistic on M&A, at least for the coming months, in particular cross-border M&A, provided that the general economic outlook remains unchanged, with low interest rates and a low euro value.

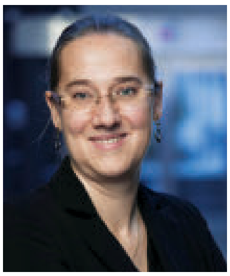
Aucomte is more bullish. As far as he is concerned, the French market attracted a large number of foreign operators and this number will probably continue to increase. Backing up his confidence, Aucomte says some private equity funds now consider the downturn to have finally bottomed, and he says there has been an uptick in foreign investment in industrial assets that helps support their hypothesis, whether those investments are via secondary or tertiary leveraged buyouts or through the acquisition of industrial groups' non-core activities.

"American, Canadian, Australian, Chinese and Singaporean funds still be interested in French operations including in project/infrastructure operations," Aucomte says. "Even if the French market has been somehow affected by new regulations implemented in 2014 and 2015, worldwide macroeconomics is in our favor and the French market still be attractive, our market concerning foreign investment being the fourth most attractive one in the world." ■

A FRENCH PERSPECTIVE:

MITIGATING CYBER RISKS IN M&A DEALS

As in the US, data breaches and cyber threats can jeopardize M&A transactions or have detrimental impact. French and European rules make it specific in various respects.



JULIE CORNELY
M&A DEPARTMENT
ALTANA

SANDRINE CULLAFFROZ-JOVER
IT & DATA PRIVACY DEPARTMENT
ALTANA

The value of the target's data assets in mergers and acquisitions should not be estimated without a comprehensive knowledge of the technical and legal measures set up for its conservation.

Mitigating cyber risks in M&A deals allows buyers to make their acquisition at market value and secure the sustainability of the acquired IT-related assets.

A recent example of critical reputational impact and data protection related liability is the acquisition by TripAdvisor, of Viator, the tour-booking company, for $200 million, in August 2014. Just a month following the acquisition, a data breach led the buyer to notify roughly 1.4 million customers that data and personal details might have been compromised following said data breach (including customers' credit card information, email addresses and encrypted passwords). This could have been anticipated with a thorough technical and legal IT assessment in the scope of the deal.

Companies increasingly rely on data and new technology to conduct their businesses, gather and store substantial know-how, and extensively harvest sensitive data notably from their customers, third party suppliers and human resources.

The potential exposure of such valued information can directly impact M&A transactions when assessing the market value of a target's assets or its brand reputation.

Several industries are more vulnerable to cyber threat than others such as Financial Services, Defense, Telecom, Retail, Energy, and Pharmaceuticals.

When targeting French companies pertaining to these industries, buyers should perform cyber-security due diligence in order not only to assess compliance with European and domestic privacy Laws but also with sector-based regulation applicable to it.

Consequently, upstream verifications have become critical during the due diligence process in the scope of M&A transactions. If appropriate cyber-security due diligence used to be overlooked in M&A deals, the opposite has become the growing trend.

RISK IDENTIFICATION

When performing due diligence including cyber-security related issues, the analysis will need to focus on the IT infrastructure scheme of the target, outsourcing management agreements, internal processes and incident/response plans.

In addition, examination of the operational processes will require particular attention in order to highlight the lines of responsibility and effective control over the data flows within the target IT infrastructure.

The IT assessment should lead to a validation of the legal framework managing such data flows in order to ensure that the three following compliance-criteria are met: Confidentiality – Integrity & Availability.

From a buyer's and investor's perspective, cyber-security due diligence should be conducted to determine:

- the collecting, storage, use or processing means of valued information (including customer or employee-related personal data);
- the classification of the processed data (i.e. in order to determine whether such data is critical for the business);
- the storage location;
- the processing management;
- the applicable personal data policies, declarative requirements, security and disaster recovery plans, and all relevant IT agreements and their day-to-day monitoring;

- the applicable insurance policies and their actual coverage;
- the past and existing, as well as actual and pending, security incidents and data breaches.

From the seller's perspective, focus should be put on the secure disclosure of sensitive personal data to the buyer and its advisors in compliance with the seller's internal privacy policy and applicable domestic privacy Laws.

RISK MANAGEMENT

Depending on the due diligence findings, adjustments or protection may need to be negotiated through particularly:

IT-related documentation: when applicable, IT documentation may need to be upgraded so as to comply with the highest technical standard applicable within both entities as well as integrate the internal policies so as to preserve the value of the IT-related asset.

SPA: when applicable, provide in the SPA for:

- Conditions precedent pursuant to which corrective actions prior to Closing are to be carried out by the seller;
- Upward or downward price adjustment depending on the due diligence findings;
- Specific representations and warranties;
- Standalone indemnity procedure(s).

Insurance Coverage: when applicable, the buyer may have to increase insurance coverage in order to cover identified potential damages and data loss risks.

FOCUS: PRIVACY ISSUES ATTACHED TO VALUABLE IT ASSETS

IT assets will be considered a valuable asset if and only if compliant with applicable Laws. This is particularly true of customer databases.

French regulation is particularly stringent as regards privacy and data security protection and generally, the buyer will need to investigate the full compliance of the disclosed proceedings attached to those assets identified as key in the transaction with the French Data Protection Act *(Act n°78-17 of 6 January 1978 on information technology, data files and civil liberties).*

When performing this compliance analysis, points of attention will defer depending on when it takes place:

- **Pre-closing:** the buyer should pay particular attention to the declarative requirements fulfilled by the target prior to the acquisition of its customer database particularly since the French Supreme Court ruled on 25 June 2013 that the sale of a customer database can be purely and simply invalidated for failure by the former applicant (i.e. data controller) to comply with Data Protection Act declarative requirements (Act n°78-17 of 6 January 1978 on information technology, data files and civil liberties).
- **Post-closing:** the buyer will in most cases be tempted to combine its own customer database with the target's for marketing purposes. In such event, the combination of both customer databases will be deemed creating of a new processing for which the prior approval of the data subject (i.e. each individual whose data is collected) is mandatory regardless of the fact that purchaser and target belong to one and the same group post closing (CNIL, ruling n°01-040, June 28th, 2001).

In cross-border M&A deals, the buyer should, in the early stages of the due diligence, identify all legal restrictions prior to transferring any personal data across E.U. borders more particularly since the E.U.-U.S. Safe Harbor Framework has been recently invalidated by the European Court of Justice *(ECJ, October 6th, 2015, Maximillian Schrems case, C-362/14).*

Consequently, an analytic review of the target's IT agreements to red flag all references to Safe Harbor Framework should allow the buyer to anticipate the implementation of suitable alternatives, such as Binding Corporate Rules (BCR) or European standard contractual clauses.

ALTANA

Altana is a full-service business law firm with 60 lawyers, offering tailor-made legal assistance in complex cross-border and domestic transactions and litigation.

Our M&A team has a very strong international focus and several of our attorneys are admitted both to the Paris Bar and to the NY Bar. We advise on public and private mergers, acquisitions, divestiture, joint venture and carve out transactions, as well as group reorganizations. We work seamlessly with the other departments of the firm, including our IT & Data Privacy department.

KEY RECOMMENDATIONS

SELLER BE AWARE OF:

- Fulfilling of appropriate and mandatory declarative requirements for processing of personal data
- Ensuring compliance of in-house privacy policies with applicable privacy Law
- Setting up appropriate secured processes to preserve valued information
- Securing the disclosure of any sensitive personal data

BUYER BEWARE OF:

- Identifying and classifying target's valued IT-related assets
- Reviewing target's data storage, security, and recovery means
- Reviewing target's IT-related contractual documentation
- Adjusting the data security process in place within the target company
- Anticipating coverage of identified risk through the IT-documentation, the SPA and/or insurance coverage