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Market Tracker Trend Report

UK Public M&A report in 2018

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Background and approach

This report aims to provide an insight into the dynamics of UK public M&A activity in 2018 and what we expect to see in 2019.

LexisNexis Market Tracker has conducted research to examine current market trends in respect of UK public M&A deals announced in 2018. We reviewed a total of 91 transactions that were subject to the Takeover Code (the Code): 42 firm offers (23 for Main Market companies and 19 for AIM companies) and 49 possible offers[1] (36 Main Market companies and 13 AIM companies) which were announced between 1 January 2018 and 31 December 2018.

The percentages included in this report have been rounded up or down to whole numbers, as appropriate.

The final date for inclusion of developments in this report is 31 December 2018. Reference has been made to deal developments after this date if considered noteworthy.

1. The 49 possible offers announced in 2018, include 10 formal sale process announcements and one announcement of a strategic review, which referred to the sale of the company as one of the options being explored.

Executive summary

Public M&A deal volume was slightly down in 2018 (42 firm offers) compared with 2017 (47 firm offers). However, this was offset by a substantial rise in deal value, with aggregate deal value of £122.1bn in 2018 (2017: £45bn) and average deal value of £2.9bn (2017: £959.5m). Of the 42 firm offers announced in 2018, 17 (40%) had a deal value of £1bn or more compared with 12 (26%) in 2017. The first three quarters of 2018 were particularly active, generating 36 deals with an aggregate deal volume of £117.5bn. The two largest deals were Takeda Pharmaceutical's offer for Shire (£45.6bn) and Comcast's offer for Sky (£30.6bn).

The five most active sectors by deal volume were Computing & IT (17%), Financial Services (14%), Pharmaceuticals & Biotechnology (12%), Engineering & Manufacturing (10%) and Media & Telecommunications (10%). Pharmaceuticals & Biotechnology and Media & Telecommunications also saw the highest aggregate deal values by sector (£49.1bn and £37.2bn respectively), boosted by the Takeda/Shire and Comcast/Sky offers.

Schemes of arrangement remain the most popular choice of structure with bidders, accounting for 74% of all firm offers announced in 2018. Two transactions (Fox's offer for Sky and DBAY Advisors' offer for Harvey Nash) saw the bidder switch from a scheme structure to an offer. On Fox's offer for Sky, the change in structure was triggered by the emergence of a competing bid from Comcast. On DBAY Advisors offer for Harvey Nash the switch to an offer appears to have been triggered by a concern that an insufficient number of independent shareholders would approve the scheme and DBAY held a significant stake in Harvey Nash prior to the offer being made.

The combination of affordable and available debt and healthy balance sheets helped to fuel M&A activity in 2018, evidenced by the number of offers involving cash. In 2018 76% of all firm offers were cash offers and 93% included a cash element. However, there were also instances of non-UK quoted bidders offering share consideration (notably Takeda on its offer for Shire), challenging the traditional perception that UK institutional investors are reluctant to take equity in a non-UK bidder.

There were only three hostile takeovers announced in 2018 (compared with six in 2017). However, 2018 saw one of the largest hostile takeovers in recent years, with Melrose's £8.1bn bid for GKN. This attracted considerable political and media attention and saw Melrose provide legally binding post-offer undertakings as well as commitments to GKN's pension scheme trustees to address concerns of the UK government, the pension scheme trustees and other stakeholders.

2018 also saw three bidders deliberately trigger a mandatory offer during the course of the offer. The motivating factors for doing this varied in each deal and included opposition to the bid from the offeree board and/or key shareholders and the presence of a rival bidder.

In 2018 there were seven companies that were the subject of potential competing bids. However, in only two cases did this progress to a scenario where the target company was subject to firm offers from competing bidders. These were Sky, which was the subject of rival bids from Twenty-First Century Fox (Fox) and Comcast and Fidessa Group, which was the subject of competing bids from Temenos and ION Investment Group. The Sky transaction took a further twist when the Panel ordered that Disney would be required to make a mandatory offer for Sky under the 'chain principle' in Rule 9 of the Code following completion of its acquisition of Fox. The Panel also implemented an auction procedure to provide an orderly framework for the resolution of the competitive bids, which resulted in Comcast emerging as the successful bidder.

Private equity buyers were active, being involved in 29% of firm offers announced during the period. Private equity buyers are also appearing on increasingly large transactions and were involved in four transactions with an offer price of £1bn or more.

Weak sterling appears to have contributed to continued interest from non-UK bidders[2], in particular from US buyers. Of the 42 firm offers announced in 2018, 74% were made by a non-UK bidder. US bidders took advantage of a strong dollar and were involved in 16 transactions, which represented 40% of all firm offers in 2018 (2017:13%).

2018 also saw several legal and regulatory developments, including:

- the Panel successfully enforcing one of its rulings that Mr David King should make a mandatory offer for Rangers football club
- Code amendments requiring bidders to provide more detailed disclosure in the offer document regarding their intentions for the offeree's business, employees and also to provide this information in the firm offer announcement and so at an earlier stage in the offer process
- the introduction of lower UK merger control notification thresholds for companies in sectors with a national security dimension
- a government consultation to strengthen the UK's national security merger rules
- draft secondary legislation and proposed amendments to the Code published by government and the Takeover Panel to deal with the UK's withdrawal from the EU

These are dealt with in more detail in this report.

2. For these purposes we have treated bidders incorporated in the Isle of Man as UK bidders.

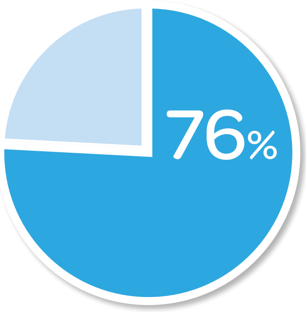
Highlights (Key-information)

42
FIRM OFFERS

£122.1bn
total deal value

£2.9bn
average deal value

COMPUTING & IT
most ACTIVE sector



76% of all firm offers were CASH OFFERS

40% of all firm offers made BY US BIDDERS

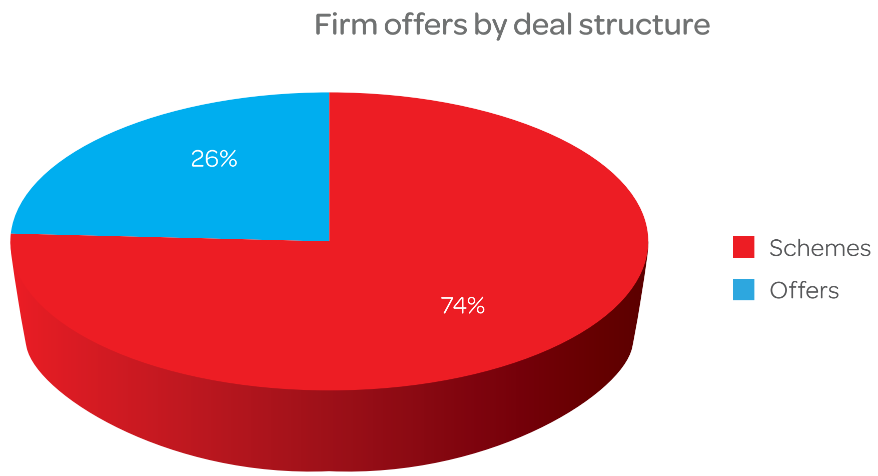
GOVERNMENT INTERVENTION on MELROSE/ GKN BID

PANEL implements AUCTION to determine COMCAST and FOX competing bids for SKY

1 Deal structure

Structuring the deal to suit the circumstances

Schemes of arrangement remain the deal structure of choice among bidders: of the 42 firm offers announced in 2018, 31 (74%) were structured as schemes and 11 (26%) were structured as offers. This represented a slight increase in the choice of schemes compared with 2017, where 62% of firm offers announced were structured as schemes and 38% were structured as contractual offers.



Schemes of arrangement are popular amongst bidders for several reasons, including certainty of obtaining 100% control: a scheme, if approved by the requisite majority will be binding on all a target's shareholders, giving the bidder complete ownership at an earlier stage than an offer. However, an offer structure can be attractive where a bidder wishes to have more flexibility to amend the acceptance condition (particularly useful on hostile bids or where there is a risk of competing bidders).

Fox's offer for Sky was initially structured as a scheme of arrangement, but Fox switched to an offer when a competing bid was announced by Comcast. Here the flexibility afforded by an offer structure appears to have outweighed the benefits of the scheme structure.

DBAY Advisors also switched from a scheme to an offer on its bid for Harvey Nash. On this transaction, DBAY Advisors had a pre-existing shareholding in the target company of approximately 26.1%. These shares would have been ineligible to vote at the shareholder meetings to approve the scheme and the decision to switch to an offer (with a majority acceptance condition) appears to have been motivated by a concern that an insufficient number of independent shareholders would approve the scheme.

> *'Switching' has been relatively uncommon to date but the combination of 75% of offers now being carried out by scheme, together with a rise in shareholder activism suggests that more offerors may well switch in the future to counter opposition to a bid. The Panel will allow a switch, provided the revised deal is no less deliverable, but it will be keen to ensure the offeree company does not remain under siege for longer than is necessary.*
> *— Simon Wood, Addleshaw Goddard*

> *Schemes of arrangement have become the default method for executing a UK public takeover. Bidders will usually need convincing reasons to choose to use a contractual offer approach instead.*
> *— Jeremy Kutner, Sullivan & Cromwell*

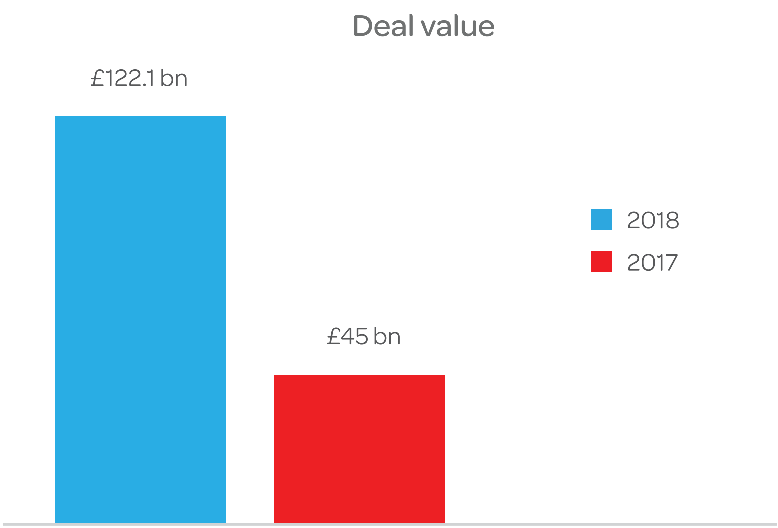
In previous reports we have noted a link between the use of schemes and deal size, with schemes of arrangement being particularly popular on larger transactions. In 2018 there was no obvious correlation with schemes being popular across all deal sizes. Factors such as the presence of a competing bidder, the attitude of the offeree board and the bidder's pre-existing shareholding in the offeree appear to have been more significant in influencing the choice of deal structure.

> *On a recommended deal, the default option remains a scheme of arrangement. After we talk our clients through the options, that's usually where they end up. In a competitive situation, an offer becomes more attractive, at least as a reserve option following a switch. Hostile or unrecommended bids invariably involve an offer. A hostile scheme remains an interesting theoretical possibility, despite the considerable obstacles.*
> *— Patrick Sarch, White & Case*

2 Deal value and volume

Deal volume in 2018 (42 firm offers) was slightly lower than in 2017 (47 firm offers). However, this was offset by a significant increase in deal value from £45bn in 2017 to £122.1bn in 2018. Average deal values also increased from £959.5m in 2017 to £2.9bn in 2018. This represented a reversal of a trend in 2017 where aggregate and average deal values were down by approximately 30% compared with 2016.

Of the 42 firm offers announced in 2018, 17 (40%) had a deal value of £1bn or more (2017: 26%). The financial services sector saw the highest number (four) of £1bn plus transactions, including Marsh & McLennan's £4.3bn offer for Jardine Lloyd Thompson Group. The two largest deals were Takeda Pharmaceutical's offer for Shire (£45.6bn) and Comcast's offer for Sky (£30.6bn).



Patrick Sarch, White & Case, comments: "*It was refreshing to see some blockbuster deals go through in 2018. Big-ticket private equity-backed deals have also re-emerged in the last couple of years. But everyone's wondering, what's next? Can this momentum be sustained, or was 2018 as good as it gets?"*

We expect to see a significant boost in deal volumes once Brexit has been resolved. Concern about potential downside scenarios, and uncertainty regarding the terms of the UK's future relationship with the EU, have led many UK businesses to defer decisions on major M&A transactions. Overseas investors have also been affected by this to a lesser extent. However, the underlying drivers for businesses to grow and adapt are not going away. Look at the long-term challenges to existing business models in financial services, retail, media, energy and the automotive sectors, for example. Once the UK M&A pipeline starts flowing again, it could move surprisingly quickly.

We're particularly excited about the potential for more public to private deals. With uninvested private equity funds at high levels, a supportive UK economic environment could unlock a wave of P2P deals in 2019. As activist investors continue to expand and explore new strategies, we feel it is only a matter of time before one of them launches a takeover bid. Perhaps this will be the year?

UK businesses will also be looking to scale up and diversify their businesses. Larger UK businesses may be more tempted to look overseas for M&A opportunities, in order to diversify their businesses or sidestep UK competition concerns. However, consolidation is likely to continue among UK players in sectors facing competitive pressure.

£1bn plus transactions

Deal	Deal Value	Deal Structure	Industry Sector (target)	Consideration structure	Bidder nationality*
Shire by Takeda Pharmaceuticals	£45.6bn	Scheme	Pharmaceuticals & Biotechnology	Cash and shares; Cash and share alternative	Japan
Sky by Comcast	£30.6bn	Offer	Media & Telecommunications	Cash only	United States
GKN by Melrose Industries	£8.1bn	Offer	Engineering & Manufacturing	Cash and shares	England and Wales
Randgold Resources by Barrick Gold	£4.6bn	Scheme	Mining, metals & extraction	Shares only	Canada
Jardine Lloyd Thompson Group by Marsh & McLennan Companies, Inc	£4.3bn	Scheme	Financial Services	Cash only	United States
NEX Group by CME Group	£3.9bn	Scheme	Financial Services	Cash and shares	United States
UBM by Informa	£3.7bn	Scheme	Media & Telecommunications	Cash and shares	England and Wales
BTG by Boston Scientific	£3.3bn	Scheme	Pharmaceuticals & Biotechnology	Cash only	United States
Vedanta Resources by Volcan Investments	£2.33bn	Offer	Mining, metals & extraction	Cash only	England and Wales
ZPG by Silver Lake Management Company V, LLC	£2.2bn	Scheme	Media & Telecommunications	Cash only	United States
Virgin Money Holdings (UK) by CYBG	£1.8bn	Scheme	Banking & Finance	Shares only	England and Wales
Fidessa Group by ION Investment Group	£1.5bn	Offer	Computing & IT	Cash only	Ireland
John Laing Infrastructure Fund by Dalmore Capital and Equitix Investment Management	£1.45bn	Scheme	Financial Services	Cash only	England and Wales
Fidessa Group by Temenos Group	£1.4bn	Scheme	Computing & IT	Cash only	Switzerland
esure Group by Bain Capital Private Equity, LP	£1.21bn	Scheme	Financial Services	Cash only	United States
Fenner by Compagnie Générale des Michelin SCA	£1.2bn	Scheme	Engineering & Manufacturing	Cash only	France
Laird by Advent International Corporation Établissements	£1bn	Scheme	Engineering & Manufacturing	Cash only	United States

*Where a bid vehicle was used, this table refers to the country of incorporation of the ultimate parent or tax residence of the ultimate shareholder

3 Target response: recommended or hostile?

Of the 42 firm offers announced in 2018, 37 were recommended from the outset. Of the remaining five, one initially received no definitive recommendation but later became recommended (offer for Sky by Comcast), one became recommended after revision (offer for Shire by Takeda Pharmaceuticals) and three were hostile (unsurprisingly, structured as contractual offers rather than schemes given the practical issues of being able to implement a scheme without the support of the offeree). This represented a 50% decrease in hostile offers compared with 2017, which saw six hostile offers.

Hostile offers

The three hostile offers announced in 2018 were Melrose's £8.1bn offer for GKN, DNO's £641.7m offer for Faroe Petroleum and Stafford Capital Partners' £197.3m offer for Phaunos Timber Fund.

All three transactions were structured as offers and both the Faroe Petroleum and the Phaunos Timber Fund offers featured cash only consideration. Melrose, whose shares were listed on the London Stock Exchange, offered GKN shareholders a mixture of cash and shares.

Deals in Focus

GKN offer by Melrose

Melrose's offer for GKN attracted considerable political and media attention and raised a number of novel issues.

Panel withdraws timetable concession

Under Rule 31.7 of the Code, all conditions to an offer must normally be fulfilled or the offer must lapse within 21 days of the first closing date or of the date the offer becomes or is declared unconditional as to acceptances, whichever is the later.

As GKN operated in the defence sector, the acquisition was conditional upon certain regulatory approvals being received from US, German and French regulatory bodies (Defence Conditions). The Panel agreed with Melrose that it would permit the extension of the 21-day period referred to in Rule 31.7 to provide further time for any outstanding Defence Conditions to be satisfied. However, this concession was predicated on Melrose taking the full 28 days allowed under the Code to post its offer document.

Melrose published its offer document 15 days after its firm offer announcement. Following the changes to the Code introduced in January 2018, this was the earliest date on which Melrose was permitted to publish its offer document without the consent of the GKN board. As the offer document had been published on an expedited basis, the Panel decided to withdraw its dispensation and informed Melrose that any request for an extension under Rule 31.7 would need to be considered in light of the circumstances prevailing at the time.

Commenting on the transaction, Patrick Sarch (Partner, White & Case) says:

"The Panel has been very focused on the timing of hostile situations recently. It has been exploring new means of balancing the siege principle (protecting targets from prolonged attack) with allowing a sufficiently free market to operate so as to allow a bidder to put a deliverable proposition to shareholders for their ultimate decision. The rulings in this situation show the Panel balancing the parties' interests in the light of arguments from both sides, with the result that Melrose was granted sufficient flexibility to be able to launch, but without having its cake and eating it by extending the overall timetable more than necessary which would have been potentially to the detriment of GKN. This is exactly the kind of dynamic, tailored regulation of real deals which the Panel does extremely well."

Post-offer undertakings

The Melrose/GKN offer also saw Melrose provide post-offer undertakings as part of its bid. This was only the second on which post-offer undertakings had been provided by a bidder. These are discussed in more detail in 'Post-offer undertakings'.

Employee Representatives

GKN's employees' representative, Unite the Union, published an opinion expressing its opposition to the Melrose bid. Concerns expressed included the potential reduction in headcount, the likelihood of strategic assets being sold and the fact that Melrose was proposing to pay an exceptional dividend to shareholders that would be financed by debt.

Pensions

The GKN Pension Scheme trustees also had an active role in the transaction. As part of its efforts to persuade GKN's shareholders to accept the offer, Melrose held discussions with the trustees and committed to inject up to £1bn into the troubled pension fund.

Adam Cain, Pinsent Masons, who advised the GKN Pension Scheme Trustees in the context of the hostile bid from Melrose considers that *"the active engagement by the GKN Pension Scheme Trustees in the bid process ensured that the issues relating to the GKN pension deficit and the safeguarding of pension benefits were given sufficient prominence during the course of the offer period by both the bidder and target company. 2018 witnessed an increase in engagement by pension scheme trustees in the offer process compared to the preceding year. This increase may be attributable to the Code changes introduced in January of 2018 relating to the timing of publication of an offer document in the context of a hostile bid. As a consequence of these changes, a target company's pension fund trustees now have sufficient time to consider the relative merits of an offer and give their views on the offeror's proposals, with those opinions being included in the relevant offer documentation."*

GKN's defence

In its defence document GKN's board argued that:

- GKN was appointing a new leadership team and launching a new strategy to substantially improve cash flow and shareholder value
- Melrose was offering a low price for the business and the transaction carried high risk owing to Melrose's smaller size, the fact that 80% of the consideration was in shares, the absence of any industrial synergies and Melrose's leveraged balance sheet
- Melrose's management team lacked relevant experience and its short-term business model was inappropriate for GKN

4 Mandatory offers

Rule 9 of the Code requires a person (or persons acting in concert) to make a takeover offer for a company subject to the Code once that person's shareholding (or those persons' combined shareholdings) in that company cross certain thresholds.

Mandatory offers are in practice infrequent, as they are generally considered as something to avoid. However, in 2018 there were three instances of bidders deliberately triggering a mandatory offer during the later stages of an offer.

On DNO's hostile takeover of Faroe Petroleum the mandatory offer was part of an aggressive bid strategy to build up a significant stake in the target business. When DNO declared the offer wholly unconditional, it had only received acceptances in respect of 14% of the target's share capital. However, as it separately held 51% of the target's shares, it was able to declare the offer unconditional.

On DBAY Advisors' offer for Harvey Nash the triggering of a mandatory offer took place after a change in structure from a scheme to an offer. Here the change in deal structure and subsequent stakebuilding appeared to be driven by a concern that certain independent shareholders might seek to block the transaction which had been originally structured by way of a scheme of arrangement (and DBAY's 26.1% existing holding would not have been eligible to vote on the scheme).

Comcast's triggering of a mandatory offer took place one week following it emerging as the highest bidder in an auction process implemented by the Panel. Here the decision to increase its shareholding to the mandatory offer threshold may have been a reflection of the competitive situation and the fact that Fox (the unsuccessful party in the auction) had a 39% shareholding in Sky.

The Sky takeover also saw the Panel issue a ruling that Disney would be required to make a mandatory offer for Sky following completion of its proposed acquisition of Fox. This was under the so-called 'chain principle' and is discussed in more detail under 'Legal and Regulatory Developments' below.

> “*Most share buyers are acutely conscious of the costs of triggering Rule 9. Some go above 30% unintentionally, and then seek to reduce their holding and obtain a Code waiver from the Panel. It's rarer to see the Panel having to enforce Rule 9, as it did in 2018 with David King and Rangers Football Club, and Disney and Sky. Mr King was caught out by the concert party rules and Disney by the seldom-seen chain principle, illustrating the potential traps in this area. However, stakebuilding remains a key tool for nervous bidders seeking to protect a non-scheme offer. As 2018 showed, some will see compliance with Rule 9 as a fair trade for a major stake in a must-have target.*
> *— Tom Matthews, White & Case*”

Deals in Focus

Faroe Petroleum offer by DNO

26 November 2018

DNO announces unsolicited cash offer for Faroe Petroleum. DNO has a pre-existing shareholding of 28% in the offeree

12 December 2018

Offer document published

20 December 2018

Offeree board publishes response document recommending that shareholders reject the offer. DNO increases its shareholding to 29.9%

3 January 2019

DNO announces it has received acceptances totalling 13% (in addition to the 29.9% interest that it already holds). DNO increases its shareholding to 30% triggering a mandatory offer

8 January 2019

DNO announces increased and final cash offer

11 January 2019

DNO increases its shareholding to 51% and declares offer wholly unconditional having received acceptances totalling 14%

Deals in Focus

Harvey Nash offer by DBAY Advisors

7 August 2018

DBAY Advisors announces recommended cash offer for Harvey Nash. DBAY Advisors has a pre-existing shareholding of 26% in the offeree

4 September 2018

Scheme document published

28 September 2018

DBAY Advisors switches from a scheme to an offer structure

8 October 2018

Offer document published

9 October 2018

DBAY Advisors announces it has increased its shareholding to 31% triggering a mandatory offer

26 October 2018

Offer declared wholly unconditional

31 October 2018

DBAY Advisors announces it has received acceptances representing 47% of Harvey Nash and that it also holds an additional 40% of the share capital

5 Competing Bids

Seven companies were the subject of potential competing bids in 2018. However, in only two cases did these bids progress to a scenario where the target company was subject to firm offers from competing bidders. These were Sky, which was the subject of rival bids from Fox and Comcast, and Fidessa Group, which was the subject of competing bids from Temenos and ION Investment Group. This is a similar level of activity to 2017, when there were six companies that were the subject of potential competing bids, of which one progressed to firm competing offers from two or more rival bidders.

The Sky transaction saw the Panel implement an auction procedure to provide an orderly framework for the resolution of the competitive bids. Rule 32.5 of the Code permits this to be done where a competitive situation continues to exist in the later stages of an offer period. The auction procedure concluded with Comcast offering £17.28 per Sky share and Fox offering £15.68 per Sky share, with Comcast's final offer represented a premium of 60.7% above Fox's original offer of £10.75 per Sky share.

> *Auction procedures are relatively rare but can be used where a competitive situation continues to exist on `Day 46' of the offer timetable in circumstances where neither bidder has yet put forward their best and final offer. The Code provides for a five round auction process to take place over five consecutive days as the default procedure to resolve a competitive situation. However, the Panel will allow the parties to agree an alternative procedure. In the case of Sky, the parties agreed a faster procedure consisting of a maximum of three rounds, which took place over a 24 hour period when the markets were shut in order to minimise disruption. Before the auction begins, the Panel will issue written instructions to the parties setting out the detailed procedural requirements for the framework agreed by them. At the end of the auction, the final offers will be announced and then the normal offer timetable resumes, meaning that the offers must be left open for at least 14 days - although the Panel will usually allow the lower offer to lapse, as it ultimately did in the case of Fox's offer.*
>
> *— Alison Smith, Freshfields Bruckhaus Deringer*

Deals in Focus

Sky – competing offers from Fox and Comcast

15 December 2016

Fox offer

Following the announcement of a possible offer on 9 December 2016, Fox announces a recommended firm offer for Sky at £10.75 per Sky share. The offer is subject to a number of competition and regulatory pre-conditions and approvals.

14 December 2017

Disney's proposed acquisition of Fox

Fox announces the merger of Fox with Disney. Fox's 39% shareholding in Sky forms part of the Disney transaction. The Panel announces that it is considering the application of the 'chain principle' in relation to the Disney transaction.

12 April 2018

Panel ruling applying the 'chain principle' in relation to Disney transaction

The Panel rules that if Disney's acquisition of Fox completes, Disney will be required to make a mandatory offer for Sky, at a price of £10.75 per share, as a result of Fox's holding in Sky.

25 April 2018

Comcast offer

Following the announcement of a possible offer on 27 February 2018, Comcast announces a firm offer. At £12.50 per Sky share, the offer is at an 16% premium to Fox's offer. The Sky board switch their recommendation from the Fox offer to the higher Comcast offer.

15 June 2018

Pre-conditions to Comcast's offer satisfied

20 June 2018

Disney increases its offer for Fox

Disney agrees to increase the consideration payable for Fox. The Panel subsequently announces that it is considering what impact this has on the consideration payable under the Chain Principle Offer.

11 July 2018

Fox and Comcast increases its offer

Fox increases its offer to £14.00 per Sky share and Comcast increases its offer to £14.75 per Sky share.

12 July 2018

Satisfaction of pre-conditions

Outstanding pre-conditions to Fox's offer are satisfied.

Deals in Focus

13 July 2018

Panel rules that Disney must increase Chain Principle offer

The Panel rules that any Chain Principle offer by Disney must be made at £14.00 per Sky Share. The Executive determines this price by analysing the relative contribution of Fox's stake in Sky in the valuation work carried out by Disney's financial advisers. This is upheld by the Hearings Committee and the Takeover Appeal Board on appeal.

20 September 2018

Panel implements auction process

After discussion with the offer parties, the Panel implements an auction procedure to resolve the competitive situation.

22 September 2018

Conclusion of auction

Comcast emerges as highest bidder with offer price of £17.28 per Sky share.

27 September 2018

Mandatory offer

Comcast carries out market purchases taking its shareholding in Sky above 30%, thereby making its offer a mandatory offer under the Code.

9 October 2018

Comcast offer wholly unconditional

Comcast acquires Fox's 39% holding in Sky and declares the offer wholly unconditional.

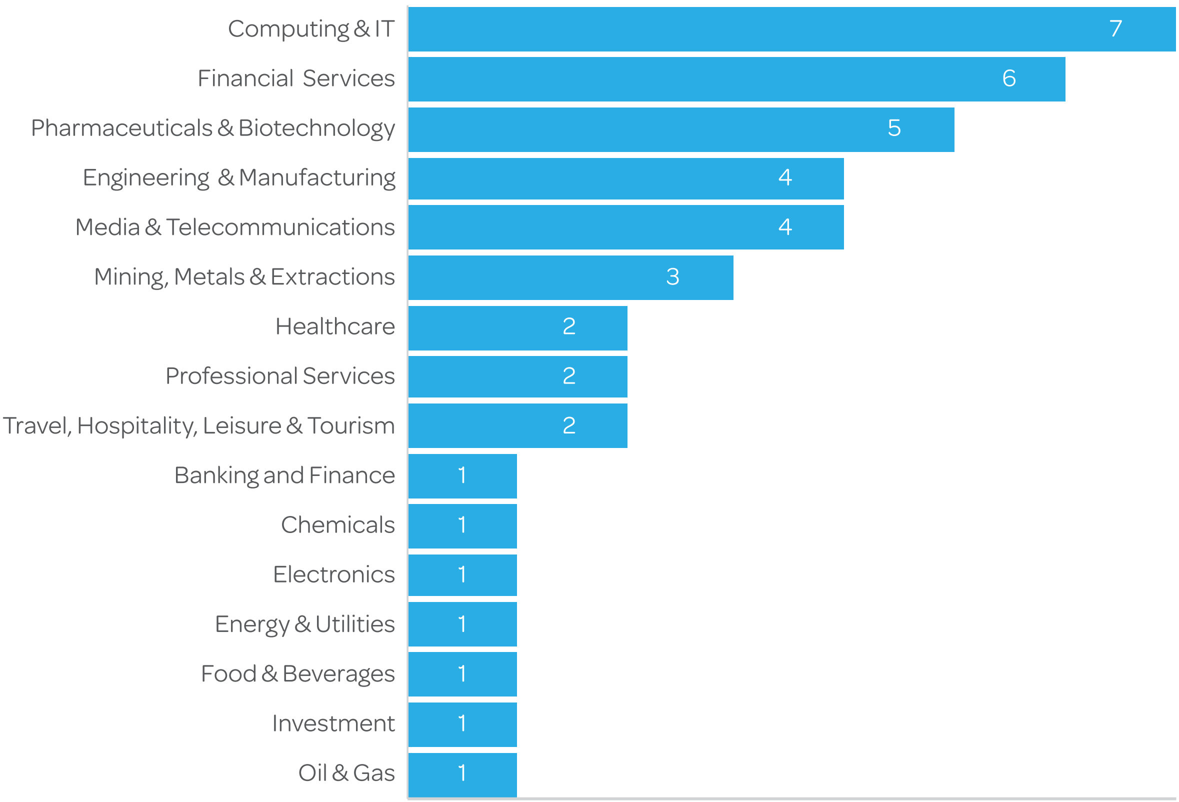
6 Industry Focus

As in 2017, public M&A activity in 2018 was not centred around one or two sectors, but across several different industries. Firm offers were made for targets operating in Computing & IT (17%), Financial Services (14%), Pharmaceuticals & Biotechnology (12%), Engineering & Manufacturing (10%), Media & Telecommunications (10%), Mining, Metals & Extractions (7%), Healthcare (5%), Professional Services (5%), Travel, Hospitality, Leisure & Tourism (5%) and seven other sectors (17%).

The Pharmaceutical and Biotechnology sector saw the highest value deal (Shire's £45.6bn offer by Takeda Pharmaceuticals). The Financial Services sector had the highest number (four) of £1bn plus transactions (offers for Jardine Lloyd Thompson Group by Marsh & McLennan, NEX Group by CME Group, John Laing Infrastructure Fund by Dalmore Capital and Equitix Investment Management and esure Group by Bain Capital Private Equity).

Other sectors which saw £1bn plus individual deal values were: Media & Telecommunications (3), Engineering & Manufacturing (3), Computing & IT (2), Pharmaceuticals and Biotechnology (2), Mining, Metals & Extraction (2) and Banking and Finance (1).

Firm offer by industry type



Top 7 sectors by aggregate deal value

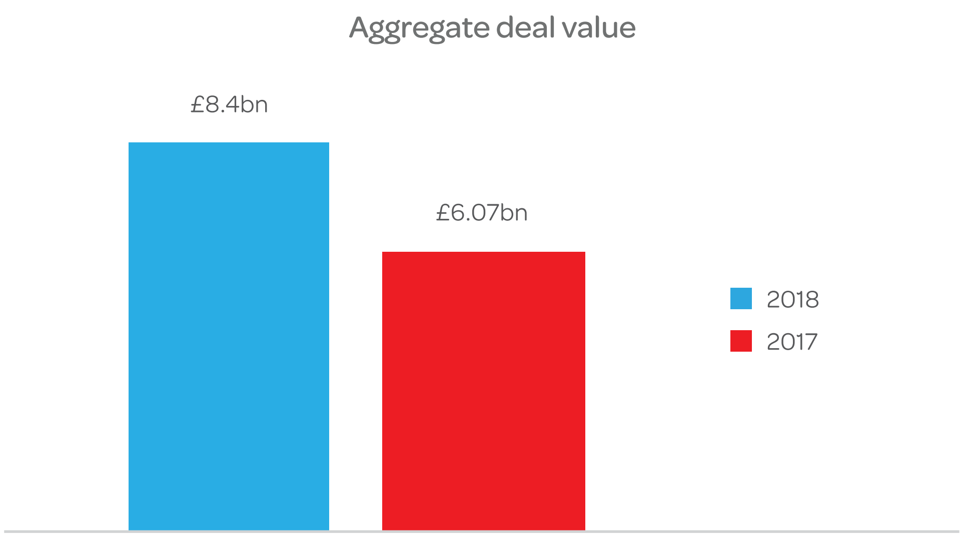
Sector	Total Sector Deal Value	As a % of aggregate deal value
Pharmaceuticals & Biotechnology	£49.1bn	40%
Media & Telecommunications	£37.2bn	30%
Financial Services	£11bn	9%
Engineering & Manufacturing	£10.35bn	8%
Mining, Metals & Extraction	£6.977bn	6%
Computing & IT	£3.3bn	3%
Banking & Finance	£1.8bn	1%

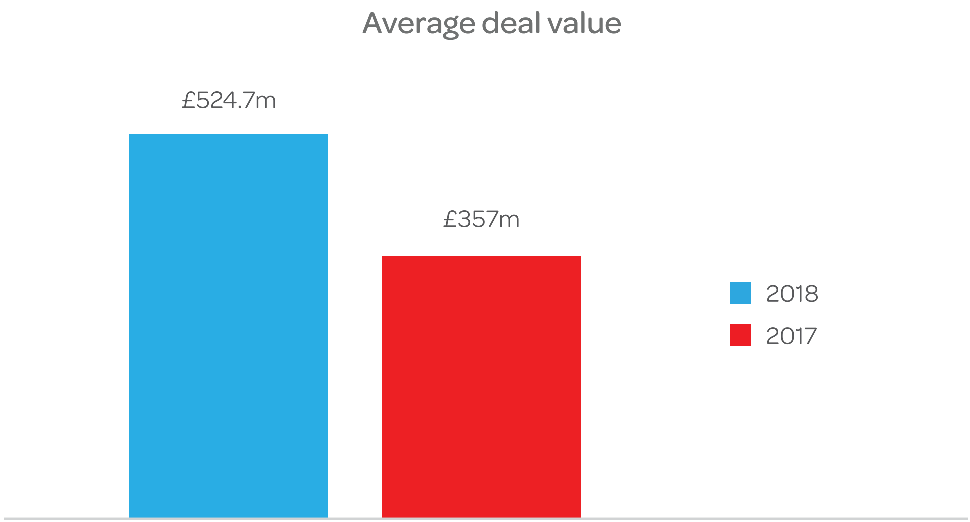
7 Public-to-private transactions

Affordable and available debt and high levels of private equity funding helped to drive public to private activity in 2018. Of the 42 firm offers announced, 17 (40%) were made by bidcos backed by private equity or individuals/family offices (eight Main Market and eight AIM target companies). 11 P2Ps were structured as schemes of arrangement and five were structured as contractual offers (including DBAY Advisors's offer for Harvey Nash Group where the bidder elected to switch from a scheme to an offer). All but one of the 16 P2P (94%) were recommended by the target board at the outset and none of the transactions involved a firm offer from a competing bidder, which indicates a reluctance on the part of financial buyers to engage in takeover activity where there is increased deal risk.

The number of P2P announced in 2018 is similar to the levels seen in 2017 (17 deals: 36% of firm offers announced in 2017), but deal values were higher. Aggregate deal value of P2P transactions was £8.4bn (2017: £6.07bn) and average deal value was £524.7m (2017: £357m). This builds on the trend we saw in 2017 of private equity's increasing appetite to engage on larger value transactions.

> "*We are seeing continued interest in P2Ps from market participants, given the desire of private equity funds to extract value from publicly listed companies that they consider to be undervalued, together with their increasing familiarity and confidence of operating within the parameters of the Takeover Code. P2P transactions should continue to be an important feature of the public M&A landscape throughout 2019.*
> — Rob Hutchings, Pinsent Masons"





> *"Note the following backdrop – with 5,106 transactions, the volume of PE buy-outs of public companies (which totaled $456 billion) in 2018 reached the highest number since the global financial crisis. With about $1.2 trillion in dry powder, whilst it may not top the record charts, we can expect to see the uplift in public to privates continue into 2019. This trend is also likely to be fueled by the attractive multiples that some listed targets are getting away at, dampened by the volatility in the UK equity markets (not aided of course by the ongoing Brexit uncertainty) coupled with signs of distress in certain sectors including parts of the consumer/ retail sector.*
> *— Selina Sagayam, Gibson Dunn"*

2018 saw four firm offers involving individuals or family offices, including the acquisition by Anil Agarwal's Volcan Investments of the remaining 13.5% interest in Vedanta Resources in a deal that valued Vedanta Resources at £2.33bn.

Public to private transactions

Deal	Deal Value	Deal Structure	Industry Sector (target)	Consideration structure	Market for target shares
Vedanta Resources offer by Volcan Investments	£2.33bn	Offer	Mining. metals & extraction	Cash only	Main
ZPG offer by Silver Lake Management Company V	£2.2bn	Scheme	Media & Telecommunications	Cash only	Main
John Laing Infrastructure Fund offer by Dalmore Capital and Equitix Investment Management	£1.45bn	Scheme	Financial Services	Cash only	Main
esure Group offer by Bain Capital Private Equity	£1.21bn	Scheme	Financial Services	Cash only	Main
Laird offer by Advent International	£1bn	Scheme	Engineering & Manufacturing	Cash only	Main
CityFibre Infrastructure Holdings offer by Antin Infrastructure Partners and West Street Infrastructure Partners	£537.8m	Scheme	Media & Telecommunications	Cash only	AIM
Hogg Robinson Group offer by GBT III B.V.	£410.5m	Scheme	Travel, Hospitality, Leisure & Tourism	Cash only	Main
Phaunos Timber Fund offer by Stafford Capital Partners	£197.28m	Offer	Investment	Cash only	Main
Communisis offer by OSG Group Holdings	£153.8m	Scheme	Professional Services	Cash only	Main

Deal	Deal Value	Deal Structure	Industry Sector (target)	Consideration structure	Market for target shares
GBGI offer by Further Global Capital Management	£101.6m	Scheme	Financial Services	Cash only	AIM
Harvey Nash Group offer by DBAY Advisors	£98.9m	Offer *initially scheme*	Professional Services	Cash only	AIM
Mytrah Energy offer by Raksha Energy Holdings	£78.9m	Offer	Energy & Utilities	Cash only	AIM
Produce Investments offer by Promethean Investments	£55.29m	Offer	Food & Beverages	Cash, loan note alternative and unlisted partial share	AIM
MayAir Group offer by Poly Glorious Investment Group	£50.35m	Scheme	Engineering & Manufacturing	Cash only	AIM
Action Hotels offer by Action Group Holdings	£35.43m	Scheme	Travel, Hospitality, Leisure & Tourism	Cash only	AIM
Abzena offer by WCAS XII-Astro	£34.4m	Scheme	Pharmaceuticals & Biotechnology	Cash only	AIM
Electronic Data Processing offer by Kerridge Commercial Systems Group	£11.85m	Scheme	Computing & IT	Main	AIM

8 Nature of consideration

Of the 42 firm offers announced in 2018:

- 32 (76%) were all-cash offers
- 6 (14%) comprised a combination of cash and shares
- 3 (7%) were all-share offers
- 1 (2%) was a cash and loan note alternative

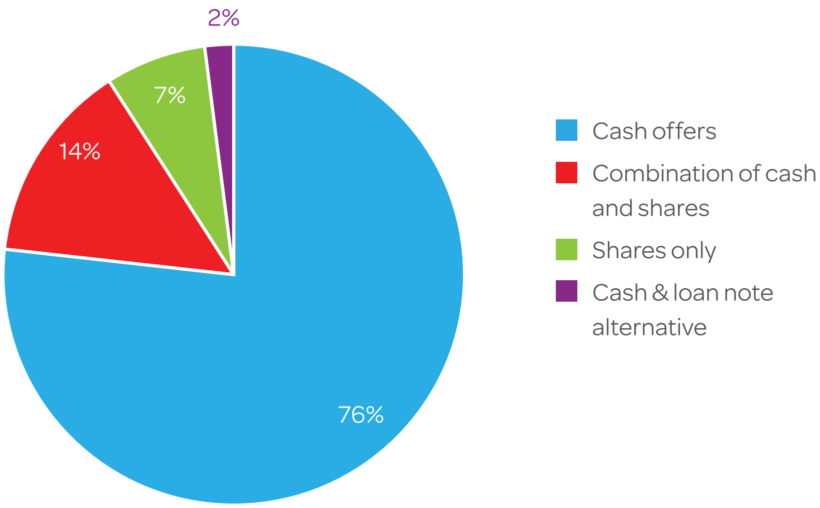
39 (93%) of the 42 firm offers announced in 2018 had some form of cash element and it was the exclusive form of consideration in 76% of deals. This is an increase from 2017, whereby cash featured in 81% of all deals and was the exclusive form of consideration in 62% of deals.

Given this trend for cash offers, it is interesting to see several offers from overseas bidders where the consideration included shares, namely:

- Tokyo Stock Exchange-listed Takeda Pharmaceutical's £45.6bn cash and shares offer for Shire
- Toronto Stock Exchange and NYSE-listed Barrick Gold's £4.64bn all-share offer for Randgold Resources
- Nasdaq-listed CME Group's £3.9bn cash and share offer for NEX Group
- NYSE-listed Pareteum's £78m cash and share offer for Artilium
- Australian Stock Exchange-listed Newfield Resource's £7.74m all-share offer for Stellar Diamonds

This data suggests that in an increasingly global market place, shareholders may be more receptive to accepting paper consideration from overseas-listed bidders, if the other offer terms are attractive.

Nature of consideration



> *The attraction of cash as the offer currency was enhanced by some uncertainty and volatility in the equity markets in 2018. Whether overseas-listed shares are acceptable partly depends on where those shares are listed. The bidder also needs to do its homework on the target's investor base. Who and where are they, and what do the institutions' investment mandates allow them to hold? The bidder will also want to consider offering a cash alternative, mix and match or free dealing facility to those who do not want overseas scrip, especially retail shareholders.*
>
> *— Philip Broke, White & Case*

Alternatives to all-cash and all-share offers

Cash and an unlisted partial share and loan note alternative

An unlisted partial share and loan note alternative was offered by Promethean Investments in its cash offer for Produce Investments. Produce Investments' shareholders were given the option of electing to receive either (a) 193p in cash or (b) 98.43p in cash, plus a unit comprising one share and a loan note issued by the unlisted bidding company. The loan note would bear interest at 11% per annum and interest would be payable quarterly, subject to the bidding company generating sufficient cash flow. The availability of the alternative consideration was limited to no more than 24.9 per cent of the issued share capital of the bidding company.

Offering unlisted securities as consideration is relatively unusual and is often prevalent where one or more shareholders (eg, the management team or founder(s) wish to retain an ongoing interest in the target business). As the Code requires all offeree shareholders to be afforded equivalent treatment and prohibits an offeror from entering into special deals which are not being extended to all shareholders, an offeror may need to offer this as an alternative to all shareholders.

American Depositary Shares (ADSs)

The consideration on Takeda Pharmaceutical's offer for Shire comprised a combination of cash and shares. To make its offer more attractive to US shareholders, shareholders had the option of taking the share consideration in the form of either new Takeda shares or new Takeda ADSs.

Mix & match

Where the consideration offered to the offeree's shareholders in a takeover bid is a mixture of securities and cash, an offeror may sometimes make available a mix and match election facility, whereby an accepting shareholder may elect for more consideration in one form than the shareholder would otherwise be entitled to, to the extent that other accepting shareholders have not taken up their full entitlement to that form of consideration.

2018 saw two offerors (Informa on its £3.9bn recommended offer for UBM and Melrose Industries on its £8.1bn hostile takeover of GKN) provide mix and match facilities (a decrease on 2017 where these facilities featured on five deals).

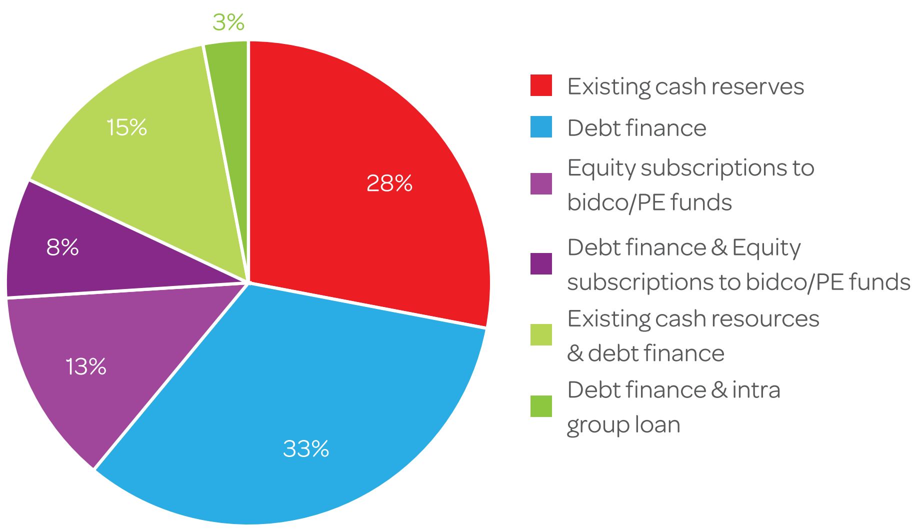
9 Financing the offer

Of the 39 firm offers that involved a cash consideration element:

- 11 were funded solely by existing cash reserves
- 13 were funded solely by debt finance
- 5 were funded solely by equity subscriptions to bidco/PE funds
- 3 were funded by a combination of debt and equity subscription to bidco/PE funds
- 6 were funded by a combination of existing cash resources and debt finance
- 1 was funded by debt finance and intra group loan

40% of transactions were financed in whole or in part by existing cash reserves (2017: 34%) and 55% involved some form of debt financing (2017: 38%). This suggests that the combination of affordable and available debt and healthy balance sheets has helped fuel M&A activity. Debt finance became increasingly important on larger deals, featuring in 80% of all £1bn plus firm offers announced in 2018. Those £1bn transactions that did not feature debt were either all share offers or were cash offers funded by equity subscriptions to bidco/PE funds.

Firm offers: funded by cash and other sources



10 UK and international bidders

Non-UK bidders[3] continued to dominate M&A activity in 2018. Of the 42 firm offers announced in 2018:

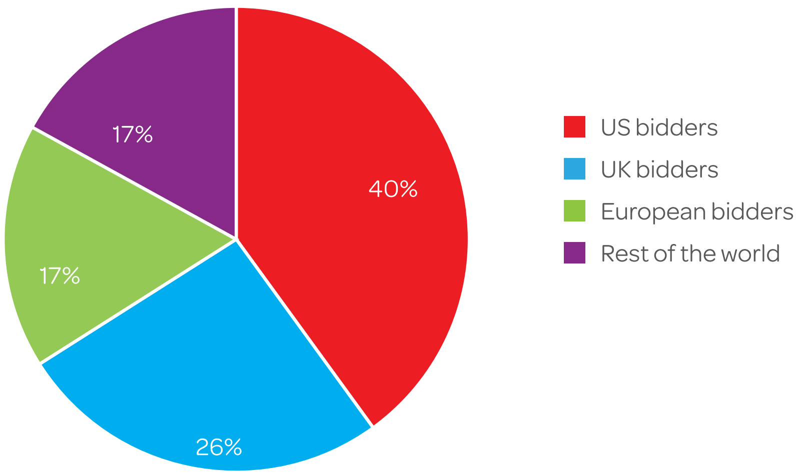
- 31 (74%) were made by non-UK bidders (2017: 68%)
- 11 (26%) were made by UK bidders (2017: 32%)

Overseas bidders were also active on the largest transactions, being involved in transactions with an aggregate deal value of £106.6bn. This represented 87% of the aggregate deal value in 2018 and was a significant increase on 2017 where overseas bidders accounted for £28.64bn (64%) of aggregate deal value. This data suggests that foreign bidders are taking advantage of the historically low value of sterling, which has been a feature since the EU referendum in June 2016.

US bidders were particularly active, featuring on 17 (55%) of the 31 firm offers announced by non-UK bidders deals with an aggregate deal value of over £48bn. This was an increase from 2017 where US bidders accounted for 25% of the firm offers announced by non-UK bidders with an aggregate deal value of £13.23bn. The most popular industry sectors for US bidders were Financial Services (23.5%), Computing & IT (17.5%), Media & Telecommunications (17.5%) and Pharmaceuticals & Biotechnology (17.5%).

> *We see the trend for US-led private equity interest in public M&A continuing throughout 2019. While the larger deals attract the headlines, we anticipate continued deal flow in the mid-market – where comparatively lower liquidity means share prices are less susceptible to Brexit-related exchange rate movements, and are thereby attractive to dollar-rich US PE funds.*
>
> *— Simon Wood, Addleshaw Goddard*

UK and international bidders



3. For these purposes we have treated bidders incorporated in the Isle of Man as UK bidders.

> *"US bidders had a busy year in 2018, benefiting from the continuing strength of the US economy and dollar. But that's not the whole story. Many overseas bidders are also better-placed to look beyond UK-specific economic, political or business risks affecting the target. Their overseas businesses and investor base may help to insulate them from these risks, and enable them to take a long-term view – for the right deal. And a lot of overseas bidders found the right deal last year, the most since 2015*
> *— Guy Potel, White & Case"*

Bidder Country*	Number of bidders**
United States	17***
China	3
France	2***
Australia	1
Canada	1
Ireland	1
Italy	1
Japan	1
Kuwait	1
Netherlands	1
Norway	1
Switzerland	1

* Where a bid vehicle was used, this table refers to the country of incorporation of the ultimate parent or tax residence of the ultimate shareholder

** This table includes all firm offers made by non-UK bidders that were analysed (whether they completed, lapsed or remained ongoing as at 31 December 2018)

*** Includes one transaction where there were joint US and French bidders

11 Possible offers & Formal Sale Processes

Firm offers

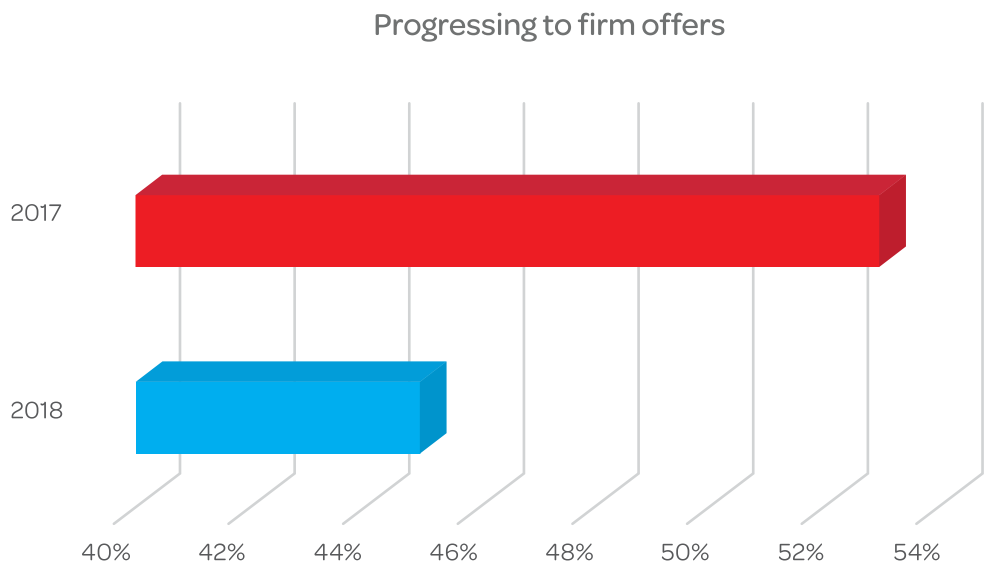
24 (57%) of the firm offer announcements made in 2018 were made without any prior possible offer, formal sale process or strategic review announcements.

Possible offers

There were 38 possible offers in 2018 identifying potential bidders in relation to 27 targets. Seven of these announcements identified multiple bidders, including IWG Group which received approaches from five potential competing bidders.

There was a slight decline in the number of possible offers progressing to firm offers in 2018 when compared with 2017. 17 out of 38 (45%) possible offers resulted in a firm offer during 2018, whereas in 2017, 18 out of 34 possible offers (53%) progressed to the firm offer stage.

Two possible offers (possible offers for Flybe Group by Virgin Atlantic Airways and RPC Group by Apollo Global Management, LLC) were ongoing as at 31 December 2018 but progressed to firm offers in 2019.



Formal Sale Processes and Strategic Reviews

Rather than being a passive participant in any potential offer process, an offeree may actively search for suitable offerors by putting itself up for sale publicly, by embarking on a formal sale process (FSP). Where an FSP has commenced, an offeree may approach the Panel for dispensations from:

- the requirements to identify publicly all offerors that have approached the offeree
- the automatic put up or shut up (PUSU) regime
- the prohibition of break fees

In 2018, 10 companies announced FSPs (seven AIM, three Main Market), compared to eight FSPs announced in 2017 (four AIM, four Main Market). In addition, one Main Market company (French Connection Group) identified the potential sale of the company as being one of a number of strategic options being considered by its board. The announcements were made by companies across a broad range of industry sectors.

Of the 11 FSPs and strategic reviews announced in 2018, four (36%) were ongoing as at 31 December 2018 and six (55%) terminated. Vernalis's FSP resulted in a £32.67m offer from Ligand Pharmaceuticals, which completed six months after the FSP announcement.

> *It does appear that the FSP process is being used by some companies that perhaps have some uncertainty as to their future as a way of putting themselves "up for sale". However, the relatively low conversion rate of FSPs into completed offers suggests that such a process doesn't guarantee an eventual offer or successful sale.*
> *— Benjamin Lee, Bryan Cave Leighton Paisner*

> *Being forced by a leak to prematurely announce a possible offer is a bidder's nightmare, but as these figures show it still happens. On top of scrambling the deal timetable, the Panel or the FCA may enquire about the bidder's procedures for managing inside information. MAR's increased record-keeping requirements will be familiar to bidders listed in Europe, but perhaps not all of the overseas and private equity bidders currently in the market. They need support to get the right procedures in place early on, before they're needed.*
> *— Allan Taylor, White & Case*

12 Break fees and reverse break fees

Break fees

Break fees payable by the offeree to the offeror are prohibited under the Code unless the Panel's consent is obtained. The Panel will only consent to a break fee being payable in limited circumstances, including:

- where, prior to an offeror announcing a firm offer, the offeree announces an FSP
- where an offeror has announced a firm offer which is not recommended by the offeree board and the offeree wishes to agree a break fee with a 'white knight' competing offeror

2018 saw two offeree companies providing break fees after a dispensation was obtained from the Panel.

On Ligand Pharmaceuticals offer for Vernalis, Vernalis agreed to pay a break fee equal to 1% of the value of any successful competing offer that was made for it. As Vernalis had announced an FSP, the Panel agreed to grant a dispensation from the prohibition on offer-related arrangements under the Code.

As part of GKN's defence strategy against a hostile offer from Melrose Industries, GKN entered into an agreement to sell its Driveline business to Dana. The proposed transaction included mutual break fees payable by both parties in certain circumstances. As Dana was not an offeror under the Code, the proposed break fee did not require the Panel's consent. However, the transaction was caught by the Code restrictions on frustrating action (Rule 21.1) and GKN shareholder consent was required.

Reverse break fees

While a target company is prohibited from agreeing a break fee with a bidder, there is no corresponding restriction on a bidder agreeing a reverse break fee with the target (except in the case of a reverse takeover).

In 2018 there were four instances of bidders agreeing to pay reverse break fees:

- Barrick Gold's offer for Randgold Resources (5% of deal value)
- Takeda's offer for Shire (2% of deal value)
- CareTech Holding's offer for Cambian Group (1% of deal value)
- Poly Glorious Investment Group's offer for MayAir Group (0.4% of deal value)

These break fees were payable in a variety of situations, such as:

- the offeror board withdrawing its recommendation for the offer
- the offeror shareholders failing to approve the transaction
- the offeror invoking one of the regulatory conditions to the offer
- the offeror breaching the terms of the co-operation agreement

This contrasts with the equivalent period in 2017 where there were six reverse break fees recorded, with break fees typically ranging from approximately 1-2.5% of the deal value.

> *"In a competitive deal environment and given the significant distraction an offer can create for an offeree company it is an issue that is raised at an early stage in most offer talks and it is likely to continue to feature in the years ahead.*
> *— Benjamin Lee, Bryan Cave Leighton Paisner"*

13 Irrevocable Undertakings

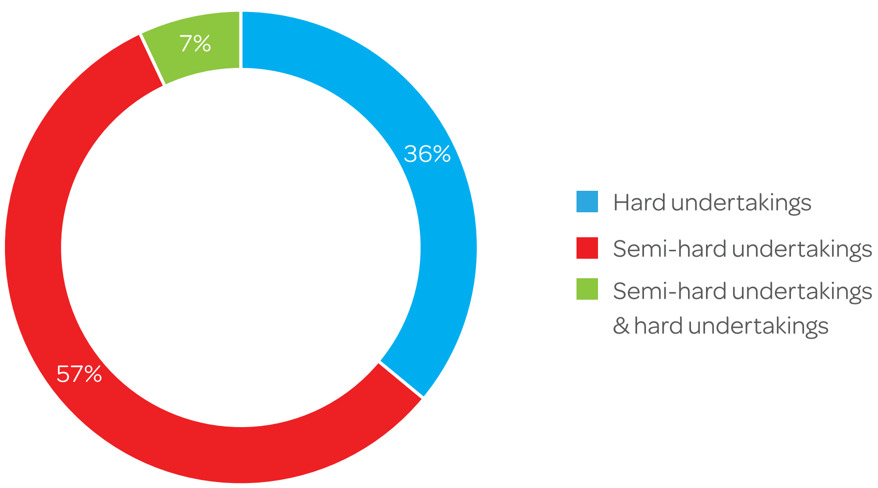
Irrevocable undertakings to accept an offer (or vote in favour of the scheme) are normally sought by an offeror from significant offeree shareholders immediately prior to the announcement of a firm offer, so as to secure as much comfort as possible that the offer will be successful. They enable the offeror to show it has substantial support for its offer as soon as it is announced and may also assist the offeror in obtaining the recommendation of the offeree board.

Hard and semi-hard undertakings (non-director shareholders)

In a number of deals in 2018, irrevocable undertakings were given by non-director shareholders in favour of bidders covering a variety of matters. Non-director shareholders provided bidders with traditional irrevocable undertakings in 28 (67%) deals. Of these 28 deals, 10 deals (36%) featured hard undertakings only, 16 deals (57%) featured semi-hard undertakings only, and two deals (7%) featured both hard and semi-hard undertakings.

Hard undertakings will remain binding if a third party makes a competing offer whereas a semi-hard undertaking will cease to be binding if a higher competing offer is made at or above a specified price, or at a price in excess of a certain percentage of the original offer price (eg, in Communisis by OSG Group Holdings, certain shareholders provided semi-hard undertakings which would lapse if a competing offer emerged that exceeded the OSG Group Holdings' offer by 10% or more).

Non-director shareholder undertakings



Matching or topping rights (non-director shareholders)

Matching or topping rights in the irrevocable undertaking allow the original bidder a limited period of time in which to match or improve on a higher competing offer before the undertaking lapses.

Matching or topping rights in irrevocable undertakings featured on 11 deals in 2018. Two deals (offer for CityFibre Infrastructure Holdings by Antin Infrastructure Partners and West Street Infrastructure Partners and offer for Vernalis by Ligand Pharmaceuticals) provided solely for a matching right. One deal (Earthport offer by Visa) provided solely for a topping right and eight deals provided for both matching and topping rights (offers for BTG by Boston Scientific, esure Group by Bain Capital Private Equity, Laird by Advent International, Hogg Robinson Group by GBT III, Artilium by Pareteum, Stadium Group by TT Electronics, Abzena by WCAS XII-Astro and Vipera by Banca Sella Holding).

Non-solicitation and notification undertakings (non-director shareholders)

Irrevocable undertakings from non-director shareholders to bidders in four deals (offers for ZPG by Silver Lake Management Company V, LLC, Laird by Advent International, Stadium Group by TT Electronics and Hogg Robinson Group by GVT III) included undertakings not to solicit or encourage third parties to make a competing offer for the target and a further obligation on the shareholder to notify the bidder if third parties indicated an interest that could lead to an offer for the company.

Shareholders activism

Activist shareholders continue to make the headlines and 2018 saw them play an active role on a number of transactions:

- activist shareholder, Elliott Capital, was publicly hostile to Temenos's recommended offer for Fidessa and came out in support of the competing bid from ION Investments
- Elliot Capital also threw its weight behind Melrose's hostile offer for GKN Fidessa Group
- Elliot Capital and shareholders represented by Greenhill unsuccessfully tried to challenge the Panel's determination of the offer price at which Disney would be required to make a chain principle offer for Sky

> *"In the course of an offer the shareholder base of the offeree can change quite considerably as traditional institutional investors sell (taking the benefit of a more liquid market and a higher share price) and activist shareholders and less traditional players can appear on share registers with significant stakes. This can create some uncertainty as to how the offer in question will be received and some of these shareholders can play a key role in extracting a higher offer price from the offeror.*
> *— Benjamin Lee, Bryan Cave Leighton Paisner"*

14 Post-offer undertakings

2018 saw two instances of bidders providing legally-binding post-offer undertakings (POUs): the Melrose/GKN and the Comcast/Sky offers. Both transactions attracted considerable media and political attention and the provision of POUs appears to have been driven by a desire to avoid government intervention.

On the GKN takeover, Melrose provided POUs that it would:

- maintain its UK listing and UK headquarters
- ensure that a majority of its directors were resident in the UK
- ensure that the Aerospace and Driveline divisions retained the rights to the GKN name
- maintain GKN's current level of research and development investment equal to 2.2% of sales over the financial periods 2019, 2020, 2021, 2022 and 2023

Each of the undertakings was given for a period of five years, except for the undertakings relating to R&D investment which was given for financial years ended 31 December 2023.

Melrose also gave commitments directly to the government regarding future disposals.

On the Sky takeover, Comcast provided POUs:

- that a member of the Sky Group would have ownership of, or the right to use, all assets, rights and licences necessary to carry on a Sky-branded news service, and that the annual expenditure on the Sky-branded news service would be maintained and increased annually for inflation for a period of five years from 1 July 2018
- that it would maintain the Sky Group's UK headquarters in Osterley for a period of five years
- that it would not acquire any majority interest in any daily, Sunday or local UK newspaper for a period of five years
- that it would establish an editorial board for the Sky-branded news service

In addition to providing POUs, Comcast and Sky entered into a legally binding deed poll in favour of the Sky News Board to:

- provide for the continued establishment of the Sky News Board for a period of 10 years
- provide the Sky News Board with oversight of the Sky News operations in relation to ensuring the editorial independence of Sky News for a period of 10 years
- provide the same investment commitment to Sky News as is included in the POUs for a further period of five years following the expiry of that POU

These commitments were legally binding and enforceable by the Sky News Board.

> *"In the context of an increasingly protectionist environment post offer undertakings are becoming a more than useful method of addressing the political and economic concerns of the UK government and the wider stakeholders in the context of takeover offers and we expect them to continue to be employed on the larger transactions.*
> *— Benjamin Lee, Bryan Cave Leighton Paisner"*

Market Comment: post-offer undertakingss

Alison Smith, at Freshfields Bruckhaus Deringer, thinks that

"We will continue to see a limited number of post-offer undertakings in larger, high profile deals in order to gain political support for transactions - they can be particularly useful for sectors which are not subject to a specific regulatory regime or to supplement undertakings given to governments or regulators. However, the parties to a bid should not underestimate the time involved in negotiating these undertakings - the Panel's overriding concern is to ensure their enforceability and it will scrutinise the undertakings carefully with this in mind. We may see the need for POUs reduce when the government implements its white paper proposals on national security and merger control, as this regime may provide a forum for some of the issues covered by POUs to be addressed."

Gillian Fairfield of Slaughter and May, comments that

"A combination of media and political scrutiny and the government engagement which can result, means that POUs are set to play a greater role than the market may have anticipated when the concept was first officially codified."

Selina Sagayam of Gibson Dunn

"Since the introduction of the voluntary post-offer undertakings regime in 2015, we have seen three instances of POUs being granted by the bidder. The expectation after the first use of the POU regime by Softbank in its recommended offer for UK chip maker ARM in 2016 was that it would only be in the most exceptional of cases where a bidder would 'voluntarily' enter into the onerous commitment and related cost and oversight of a POU. In 2018 we have seen not just one but two instances of the use of POUs.

So what does all of this say about POUs going forward. Two observations – First, we may see more examples of the use of POUs as a tool to differentiate a bid in a competitive situation. Secondly, in the light of the changing protectionist landscape – specifically the proposed new national security and infrastructure investment regime (coined by some as the 'UK CFIUS'), we should expect to see more instances of POUs being 'voluntarily' granted in favour of target companies. If and when the UK CFIUS regime is in place, the question which will come into sharper focus is who the POUs should be granted in favour of – the target company or the new ministerial department which will be given oversight of the new regime? When the Panel introduced the POU regime in 2015, it was made clear that they would prefer not to be left with responsibility for the ongoing monitoring and enforcement of the POUs once granted – indeed if there were another regulatory or governmental body better suited to provide oversight, they would be engaging with the parties to shift the responsibility accordingly.

Dominic Ross of White & Case notes that

"Target shareholders are the primary audience for any bid. However, other stakeholders may take (and pressure the government to take) an intense interest in politically-sensitive deals. Post-offer undertakings provide one way to assuage their concerns. The POU regime has its limitations – as shown by the provision of additional non-Code commitments from Melrose to the government, and from Comcast in favour of the Sky News Board. This is a challenging area for the Panel and I have sympathy for them, given that this is a relatively new regime, and it may be particularly difficult for them to supervise the post-takeover conduct of businesses by unlisted companies."

15 Disclosure of bidder's intentions – business, employees and pensions

Rule 25.9 of the Code entitles the offeree's employee representatives and pension scheme trustees to require the offeree to publish their opinion on the effects of the offer on employment and on the pension scheme. To address a lack of engagement by employee representatives and pension scheme, under the existing regime the Panel amended the Code so that from 8 January 2018, bidders are required to include in the firm offer announcement details of their intentions regarding the offeree's business, employees and pension schemes. Previously this information was only required to be included in the offer document and the Panel hoped that by requiring this information at an earlier stage in the offer process, this would assist the target company's employee representatives and pension scheme trustees in formulating their opinions on the offer and hence published in the context of shareholders considering the offer. To further assist in creating the opportunity for such opinions to be published the Code was also amended to require a minimum 14 day period between the date of the firm offer announcement and the publishing of the offer document (unless the offeree board consents otherwise).

The Panel also expanded the matters to be included in the offeror's statement of intentions to cover:

- the offeree's research and development functions
- any change in the balance of the skills and functions of the offeree's employees and management
- the location of the offeree's headquarters and headquarters functions

These amendments also introduced from 8 January 2018 sought to address a lack of specificity of certain statements of intention made by offerors under Rule 24.2(a).

To date these amendments appear to have had a mixed effect. On Melrose's hostile takeover of GKN, GKN's employees' representative, Unite the Union, published an opinion expressing its opposition to the Melrose bid. However, this was very much an isolated example and it seems likely that the provision of the Unite opinion was driven by Unite's concern about the potential reduction in headcount as a result of the transaction and the political and media attention generated by the Melrose bid rather than the recent Code reforms.

The Panel appears, however, to have had more success with encouraging bidders to be more detailed in their published statements of intention. In 2018 bidders provided increasingly detailed and specific disclosures about their post-acquisition plans, in particular around headcount reduction, research and development functions and location of the offeree's headquarters and headquarter functions.

Market Comment: disclosure of bidder's intentions

Alison Smith, at Freshfields Bruckhaus Deringer, notes that

"The Panel continues to expect the parties to a bid to provide detailed and high quality disclosures around their intentions for the target business, and this is likely to remain a focus. Now that the disclosures have been brought forward to the firm offer announcement, bidders need to build in sufficient lead time both to formulate their intentions and to liaise with the Panel. The implications of any synergy planning also needs to be thought through carefully, particularly where it affects headcount."

Rob Hutchings of Pinsent Masons considers that

"The Panel has clearly increased its focus on intention statements made by a bidder over the course of recent years. The sentiment demonstrated in the consultation paper on intention statements issued in September 2017 demonstrates that the Panel is concerned about the trend of intention statements which are very generic in nature. We are seeing increasing scrutiny of these intention statements by the Panel when acting on takeovers and this reflects the desire to provide shareholders with as much information as possible about the bidder's plans."

Gillian Fairfield of Slaughter and May considers that

"This change represents a better alignment of directors' duties and takeover-related disclosure. In reaching a decision as to whether or not to recommend any given deal and on what terms, the target board also has regard to wider stakeholder factors, such as the bid's effect on target employees and the community. Accordingly, it makes sense to share the long-term commercial justification for the offer and the bidder's intentions for the target's business and employees etc. at the stage of the 2.7 announcement, when the recommendation is first given."

Benjamin Lee of Bryan Cave Leighton Paisner comments that

"In the context of a more politically charged environment bidders and their advisers need to allow for more time in formulating and settling such intention statements with the Executive and given the rule changes referred to above that process now takes place earlier in the process (as such statements are required to be included in the firm offer announcement)."

Tom Matthews of White & Case comments

"Bidders' disclosures in Rule 2.7 announcements regarding their post-acquisition intentions should be informed by due diligence, any consultation requirements for employment or pensions-related changes, the bidder's employee communications plan and any proposed disclosures about synergies or cost savings. It's yet another example of the need to take a joined-up, forward-looking approach."

16 Legal and regulatory developments

Enforcement of the Code through the Courts

2018 saw the first instance of the Panel enforcing one of its rulings through the courts.

Previously, the Appeal Board had upheld rulings of the Executive and of the Hearings Committee that Mr David King had acted in concert with three other individuals to acquire more than 30% of the voting rights in Rangers Football Club and had thereby incurred an obligation under the Code to make a mandatory offer for Rangers. When Mr King failed to comply with the ruling, in 2018 the Panel initiated proceedings in the Scottish courts under section 955 of the Companies Act 2006 (CA 2006). The Panel was successful in its application and the court ordered Mr King to comply with the Panel's rulings that he should make a mandatory offer for Rangers. This order was then upheld on appeal. The decisions provide some clarification in the following areas:

- the court rejected the argument that because the offer price of 20p per share was below the current trading price of 25p per Rangers share, the offer would serve no practical purpose. The difference in price was not great and some shareholders might be anxious to realise their shares quickly and easily
- proceedings under CA 2006, s 955 are not appellate in nature and do not involve a rehearing of the issues before the Hearings Committee and the Appeal Board. Therefore, in the absence of any serious errors on its face, the findings of fact made by the Hearings Committee and the Appeal Board were binding on the court
- if an order is made by the Panel requiring a mandatory offer, the court should enforce it in the absence of exceptional circumstances. These circumstances might include an insolvency event occurring after the 30% shareholding had been acquired

For further details, see News Analysis:

Court grants an Order requiring Mr King to make a mandatory offer under the Takeover Code (Panel on Takeovers and Mergers v King) and Scottish appeal court upholds decision requiring King to make Rule 9 offer for Rangers

Chain principle offer

During the competition reference period of Fox's offer for Sky, Fox and Disney entered into an agreement for Disney to acquire Fox after a spin-out of certain Fox assets. As Fox had a 39% interest in Sky, the Panel ruled that Disney would be required, following completion of its acquisition of Fox, to make a mandatory offer (Chain Principle Offer) to Sky ordinary shareholders pursuant to the 'chain principle'.

This principle (set out in Note 8 on Rule 9.1 of the Code) requires a mandatory offer to be made in certain circumstances where a person acquires 50% or more of the voting rights of a company (which need not be a company to which the Code applies) and, as a result, acquires or consolidates control of another company to which the Code does apply by virtue of the first company's interest in that second company. The Code only requires a so-called 'chain principle' bid to be made when the second company is of 'significance' to the potential offeror, which the Panel interprets as being when either:

- the interest in shares which the first company has in the second company is 'significant' in relation to the first company, taking into account factors such as the assets, profits and market values of the respective companies (relative values of 50% or more normally being regarded as significant), or
- securing control of the second company might reasonably be considered to be a significant purpose for the persons acquiring a controlling interest in the first company

The Code does not make provision for the price at which such an offer must be made and in this case the Panel determined that the Chain Principle Offer should be made at £10.75 per Sky share. In arriving at this ruling, the Panel reviewed Disney's internal and external valuation materials and concluded that this was the price attributed by Disney to Fox's shareholding in Sky. The Panel commented that had Disney or its concert parties acquired any Sky shares in the 12 months prior to the Fox acquisition, the Panel would have taken this into account in determining the offer price for the Chain Principle Offer.

The application of the chain principle took a further development in the Sky transaction when Disney increased its offer for Fox from US$28 to US$38 per Fox share. Shortly after this announcement, Fox (which was in a competitive situation with Comcast) increased its offer for Sky to £14 per share. The Executive ruled that the price at which Disney would be obliged to make a Chain Principle Offer should be increased to £14 per Sky share. This decision was upheld by the Hearings Committee and the Takeover Appeal Board.

In reaching this decision, the Appeal Board rejected arguments that the Chain Principle Offer price should be based on a 'true', 'fair' or 'reasonable' value of the Sky shares. It also rejected the argument that the revised offer price should be determined by applying, as a starting point, a proportionate linear increase in price to the previously determined offer price of £10.75 per share, or on some other basis, such as an increase in enterprise value. There was nothing in the Code to require the Chain Principle Offer to be made on this basis. Instead the criteria for determining the offer price were those of equivalent treatment and shareholder protection under the Code. It also dismissed any argument that an independent expert should be engaged to assist the Executive in assessing the value of the Sky shares.

The Executive had correctly made enquiries of Fox and Disney in order to determine whether in the negotiation of the purchase of Fox, any price per share had been attributed to Fox's shareholding in Sky. It then examined whether there was other evidence which indicated an agreement between Disney and Fox on a price per share for Fox's shareholding in Sky, and in particular examined the valuation materials which were prepared to support Disney's offer for Fox.

The Hearings Committee had concluded that the most reliable piece of evidence for inferring the value attributed by Disney to Fox's stake in Sky was the £14 per share price at which Disney authorised Fox to bid for the remaining shares of Sky on 11 July 2018. In authorising and supporting this bid, the Appeal Board noted that Disney had agreed to take on the increase in debt which Fox would have to incur to make the offer. Disney also undertook to indemnify Fox for liabilities attributable to the offer price exceeding £13 in the event the acquisition of Fox did not complete for regulatory or other specified reasons.

For further details, see News Analysis:

Panel confirms that Disney will need to make mandatory offer following Fox acquisition and Takeover Appeal Board examines chain principle on Sky offer

Merger control and national security

Amendments to merger control thresholds

From 11 June 2018, amendments were made to the UK merger control regime's notification thresholds for the following sectors related to national security:

- military or dual-use goods which are subject to export control
- quantum technology
- computing processing units

For transactions in these sectors, the UK turnover threshold is reduced from £70m to £1m. In addition, the UK share of supply test (25%) has been amended so that it can be met solely by the activities of the target.

The government intends that these changes will allow it to intervene in smaller mergers in those sectors which might give rise to national security implications.

Government consultation

In July 2018, the government launched a consultation on proposals to strengthen the UK's national security merger rules.

The proposals, in the National Security and Investment White Paper, include new powers for the government to scrutinise the purchase of assets (such as IP rights) regardless of the UK's merger control thresholds, if they raise national security concerns. Businesses and investors will be encouraged to notify the government ahead of transactions that might give rise to national security risks.

The government will have a 'call-in' power for transactions that may give rise to national security risks so it can assess them more fully, with remedies including confirmation to proceed or blocking a deal. The proposals are aimed at ensuring the regime keeps pace with new technologies and innovation.

> *"The UK government's White Paper proposals represent a significant broadening of its powers to intervene in transactions on national security grounds, and as they currently stand there is a concern that it will be difficult to establish with certainty which transactions will be caught. The proposals represent a more general trend that we are seeing for increased politicisation of M&A deals across the globe. Much earlier thought should therefore be given by the parties to the risk of government intervention – both in the UK and elsewhere - and early engagement with key stakeholders should be considered where appropriate. Careful deal structuring and a consistent narrative will be more important than ever to minimise the risks of a deal failing.*
> *— Alison Smith, Freshfields Bruckhaus Deringer"*

Brexit

As part of its preparations for the UK's exit from the EU, the government has published several pieces of secondary legislation, which are intended to facilitate the effective functioning of the UK's company law framework and to facilitate the effective operation of the UK takeovers regime on a freestanding basis outside the EU framework post-Brexit.

Proposed revocation of the Companies (Cross-Border Mergers) Regulations

In November 2018 the government published the draft Companies, Liability Partnerships and Partnerships (Amendment etc) (EU Exit) Regulations 2018. These were replaced in January 2019 by the Companies, Liability Partnerships and Partnerships (Amendment etc) (EU Exit) Regulations 2019. The draft instrument revokes the Companies (Cross-Border Mergers) Regulations 2007 as after exit day the UK will no longer have access for this regime, which is designed for mergers to occur between companies established in different EEA member states.

For further details, see News Analysis:

Government publishes instrument to amend Companies Act regime post-Brexit

Takeovers (Amendment) (EU Exit) Regulations 2019

In October 2018 the government published the draft Takeovers (Amendment) (EU Exit) Regulations 2019 (Takeovers (EU Exit) Regulations), which propose a number of amendments to Part 28 of the CA 2006 to facilitate the effective operation of the UK takeovers regime on a freestanding basis outside the EU framework post-Brexit. The draft regulations also proposes the removal of the shared jurisdiction regime from the Code.

For further details, see News Analysis:

Government publishes amending regulation to address UK takeover regime post-Brexit

Proposed amendments to the Code

Following the government's publication of the Takeovers (EU Exit) Regulations, the Panel published PCP 2018/2, which proposed a number of changes to the Code arising from the UK's withdrawal from the EU. These included the proposed deletion of the shared jurisdiction rules in Section 3(a)(iii) of the Code.

Upon the deletion of the rules, the Code would no longer apply to an offer for:

- a company which has its registered office in an EEA Member State (ie not in the UK) and whose securities are admitted to trading on a regulated market in the UK (but not in that EEA Member State), or
- a company which has its registered office in the UK and whose securities are admitted to trading on a regulated market in an EEA Member State (and not on a regulated marked in the UK) and which does not satisfy the 'residency test' in Section 3(a)(ii) of the Introduction to the Code

The Code would, however, then apply (in full) to an offer for a company which has its registered office in the UK and whose securities are admitted to trading on a regulated market in an EEA Member State (but not on a regulated market in the UK) if that company satisfies the residency test in Section 3(a)(ii) of the Introduction to the Code.

In PCP 2018/2, the Panel considered whether, following the UK's withdrawal from the EU, the Code should be amended so as to remove the references to Phase 2 European Commission proceedings, such that clearance from the European Commission would be treated under the Code in the same way as clearance from any competition or anti-trust regulator other than the CMA. The Panel has decided not to amend the Code requirements dealing with Phase 2 European Commission proceedings, but will keep this position under review.

Adam Cain, who has responded to the Panel Consultation Paper on behalf of Pinsent Masons stated that *"whilst I can understand the degree of pragmatism that the Panel is demonstrating by attributing equivalent status to the CMA and EU merger regimes under the Code, the decision appears slightly divorced from the political reality facing market participants following the UK's withdrawal from the EU. In the long term, I see merit in an alignment of the respective competition regimes under the Code, such that the EU merger regime is given equivalent status to that of such other competition regimes. It appears illogical to single out the EU merger regime over any other competition regime elsewhere in the world."*

For further details, see News Analysis:

Analysing the proposed amendments to the Takeover Code arising from Brexit.

Market Comment: Brexit

Selina Sagayam of Gibson Dunn notes that

''We have now heard from the Code Committee on their proposals to reform the jurisdictional reach of the Code in the light of Brexit – a paring down of jurisdiction as expected. What will be interesting is to see what if any action the so-called 'orphan' companies (which will be left without a designated takeover regulator) will do in the light of this development – will the interests of shareholders seeking the protection of a formal regime prevail?

The other key development that many practitioners, investors and buyers are keenly watching is what shape the proposed new 'UK CFIUS' will take – will there be a softening of the broad remit and scope outlined by the government in the July 2017 White Paper or indeed will there be a hardening of approach – which some expect if there is a change of government? Whatever the outcome, even as outlined today, the new regime is likely to have a material impact on the shape and dynamics of UK M&A in the future''.

Patrick Sarch of White & Case, considers that

"Lawyers understandably tend to focus on the actual legal changes needed to implement Brexit. These will not be major for the UK takeovers regime. Yes, the loss of prospectus passporting will require some extra work to extend a non-scheme securities offer to target shareholders in the EEA, for example. We expect this may motivate the use of schemes to obviate the need for a prospectus where relevant. However, bidders are much more concerned about how to manage the business risks posed by an uncertain Brexit landscape. Due diligence can help them to assess how different scenarios might impact the target. Conditions in their takeover offer might help in a worst-case situation – it was interesting to see Brexit-related conditions in Visa and Mastercard's offers for Earthport and Connect Airways' offer for Flybe. But what bidders really want are more certainty and less downside risk. The rest will follow."

General Trends

With the UK Monetary Policy Committee having just unanimously voted to keep interest rates on hold (Brexit uncertainty) and the US Federal Reserve taking a more dovish than hawkish outlook on interest rate rises in 2019 thus supporting the availability of cheap debt or attractive bid financing costs and sterling currency weakness – UK listed targets will continue to be an attractive opportunity for US buyers and we can expect US bidders to once again top the foreign bidders league table by head and shoulders.

Other factors which could potentially fuel public M&A activity are the increase in shareholder activism and event-driven activism (spin-offs, takeovers etc). 2018 saw a record number of companies which were subject of activist action globally with a corresponding sharp increase in the UK (which saw investors launching campaigns in 25 companies). 2019 is already showing signs of significant activity with new 'entrants' applying pressure on companies including some large cap targets.
— Selina Sagayam, Gibson Dunn

Firm offers included in the report

Abzena plc offer by WCAS XII-Astro, L.P.
Action Hotels plc offer by Action Group Holdings Co KSCC
Artilium plc offer by Pareteum Corporation
Bioquell plc offer by Ecolab Inc.
BTG plc offer by Boston Scientific Corporation
Cambian plc offer by CareTech Holdings plc
CityFibre Infrastructure Holdings plc offer by Antin Infrastructure Partners and West Street Infrastructure Partners
Communisis plc offer by OSG Group Holdings, Inc.
Earthport plc offer by Visa Inc.
Electronic Data Processing plc offer by Kerridge Commercial Systems Group Limited
esure Group plc offer by Bain Capital Private Equity, LP
Faroe Petroleum plc offer by DNO ASA
Fenner plc offer by Compagnie Générale des Établissements Michelin SCA
Fidessa Group plc offer by ION Investment Group Limited
Fidessa Group plc offer by Temenos Group AG (lapsed)
FreeAgent Holdings plc offer by The Royal Bank of Scotland Group plc
GBGI Limited offer by Further Global Capital Management, L.P.
GKN plc offer by Melrose Industries plc
Harvey Nash Group plc offer by DBAY Advisors Limited
Hogg Robinson Group plc offer by GBT III B.V.
Jardine Lloyd Thompson Group plc offer by Marsh & McLennan Companies, Inc
John Laing Infrastructure Fund Limited offer by Dalmore Capital Limited and Equitix Investment Management Limited
Laird plc offer by Advent International Corporation
Lombard Risk Management plc offer by Vermeg Group N.V.
MayAir Group plc offer by Poly Glorious Investment Group Limited
Mytrah Energy Limited offer by Raksha Energy Holdings Limited
NEX Group plc offer by CME Group, Inc.
Phaunos Timber Fund Limited offer by Stafford Capital Partners Limited
Plant Impact plc offer by Croda International plc
Produce Investments plc offer by Promethean Investments LLP
Randgold Resources Limited offer by Barrick Gold Corporation
Shire plc offer by Takeda Pharmaceuticals Limited
Sinclair Pharma plc offer by Huadong Medicine Co., Ltd.
Sky plc offer by Comcast Corporation
Stadium Group plc offer by TT Electronics plc
Stellar Diamonds plc offer by Newfield Resources Limited
UBM plc offer by Informa plc
Vedanta Resources plc offer by Volcan Investments Ltd
Vernalis plc offer by Ligand Pharmaceuticals Incorporated
Vipera plc offer by Banca Sella Holding S.p.A.
Virgin Money Holdings (UK) plc offer by CYBG plc
ZPG plc offer by Silver Lake Management Company V, LLC

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Selina is the Head of UK Transactional Practice Development in the London office of Gibson, Dunn & Crutcher. She is an English qualified lawyer who joined the firm as a partner in 2007. In her practice development role, Ms. Sagayam is responsible for the Knowledge and Practice Management and functions of the firm's English law Transactional Practice. She is a member of the firm's international Mergers and Acquisitions, Hostile M&A and Shareholder Activism, Capital Markets and Securities Regulation and Corporate Governance Practice Groups.

She was seconded for two years to the Takeover Panel and is regularly called upon as a key adviser and commentator on UK and European takeovers. She is a regular speaker at conferences in the UK and Europe on takeovers and cross-border M&A, has authored numerous articles on corporate finance and corporate governance issues and is regularly quoted and interviewed in the financial press and media for her views on M&A transactions.

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Patrick is co-head of both White & Case's UK Corporate Practice and the Financial Institutions Global Industry Group. As a senior corporate partner, Patrick is valued by his wide range of clients for providing commercial, pragmatic and sound business advice. He is widely viewed as a trusted adviser to the boards of many UK and international listed companies.

Patrick has over 20 years' experience advising clients on corporate finance, domestic and cross-border public company M&A (with extensive expertise in competitive and hostile situations), innovative structuring, the Takeover Code, disclosure issues, securities law and the Listing Rules as well as secondary issues and capital restructuring. He has a very broad base of skills and also advises on corporate aspects of investigations and crisis management. He has advised on a number of global and UK "firsts" and record breaking deals. Patrick is a member of the City of London Law Society Company Law Committee.

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