DACH Trendspotter: region fares better than Europe, sponsor resilience offers hope

Analysis 03 JUL 2020

- M&A down 12.2% to EUR 67.6bn, compared to 29% fall across continent
- Mid-cap sponsor deals keep deal flame alive in lockdown months
- Corporates streamlining, distressed assets to boost H2 deal pipeline

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DACH dealmakers seem so far to have weathered the coronavirus pandemic better than their European neighbours. While M&A activity still took a significant hit after lockdown measures were implemented, *Mergermarket* data shows that the German-speaking region has come to the end of the first half of 2020 better off than the rest of the continent.

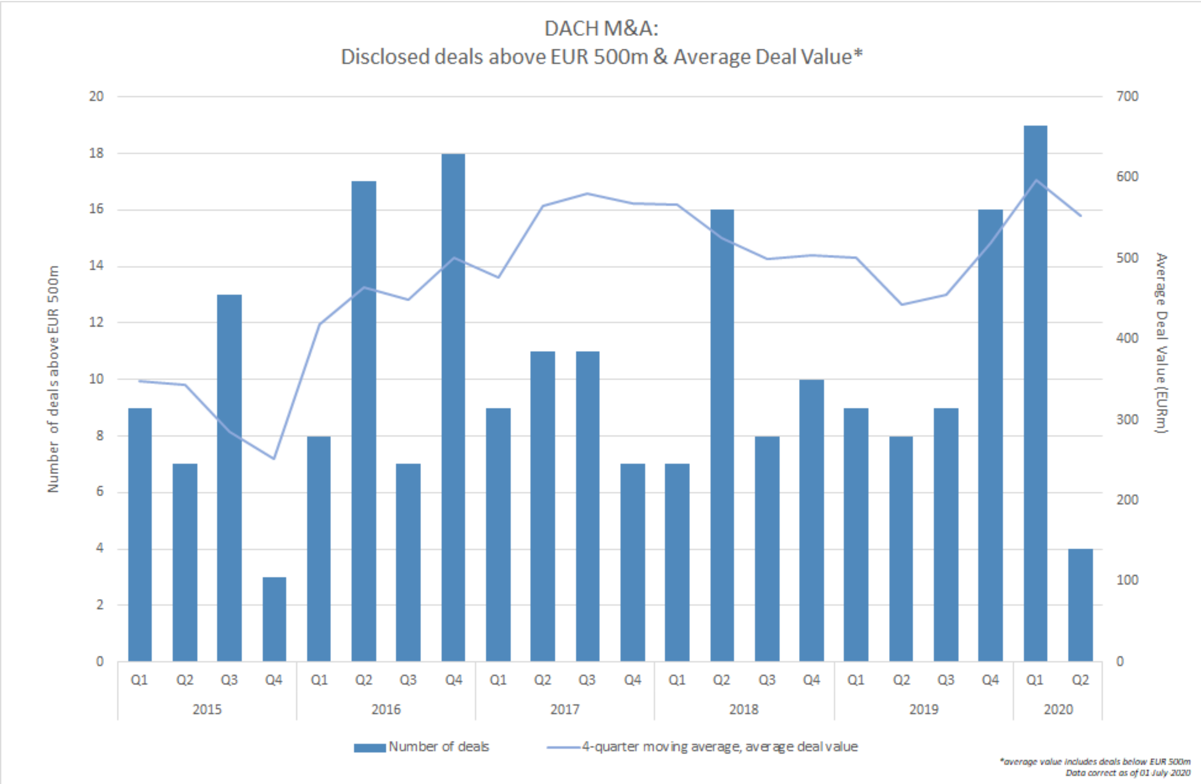
A total of EUR 67.6bn changed hands via M&A involving targets in Germany, Austria and Switzerland in the first half of this year, 12.2% less than a year ago – a smaller drop than the 29% decrease seen across Europe in the same period. In volume terms, the number of transactions was down 28.1% to 454, compared to a 36.9% fall in the continent, according to *Mergermarket* data.

Even though several sale processes dwindled, robust crisis response from governments and an early return to business seem to have provided adequate confidence for cutting deals. However, a return to normality will not be immediate and dealmakers remain cautious.

"COVID-19 will have a major impact on the transaction activities in the DACH region in the foreseeable future as the current uncertain market environment will slow down deal activity," said Volker Geyrhalter, head of corporate Continental Europe at **Hogan Lovells**. Companies are focusing on cash-flows and are not prepared to make investments which could be done later on, he said.

The DACH region saw brisk activity in this year's pre-pandemic months, being able to make the most of the last weeks of a decade-long bull market for deals. The region also benefited from a resilient mid-cap private equity industry that helped keep the M&A flame alive during the lockdown period.

Soaring pre-pandemic values were thanks in part to multi-billion euro transactions such as **Thyssenkrupp**'s [ETR:TKA] sale of its elevator unit to **Advent**, **Cinven** and **RAG foundation** for EUR 17.2bn in February, and the acquisition of **Deutsche Glasfaser** by **EQT** and **OMERS** for EUR 2.8bn in the same month. More interestingly, a record number of 19 deals valued at above EUR 500m were announced in the region, contributing to 1Q20 being the region's second-best quarter in deal value terms since the 2008 financial crisis at EUR 58.6bn, just short of 2Q17's record-breaking EUR 61.1bn in deal value.

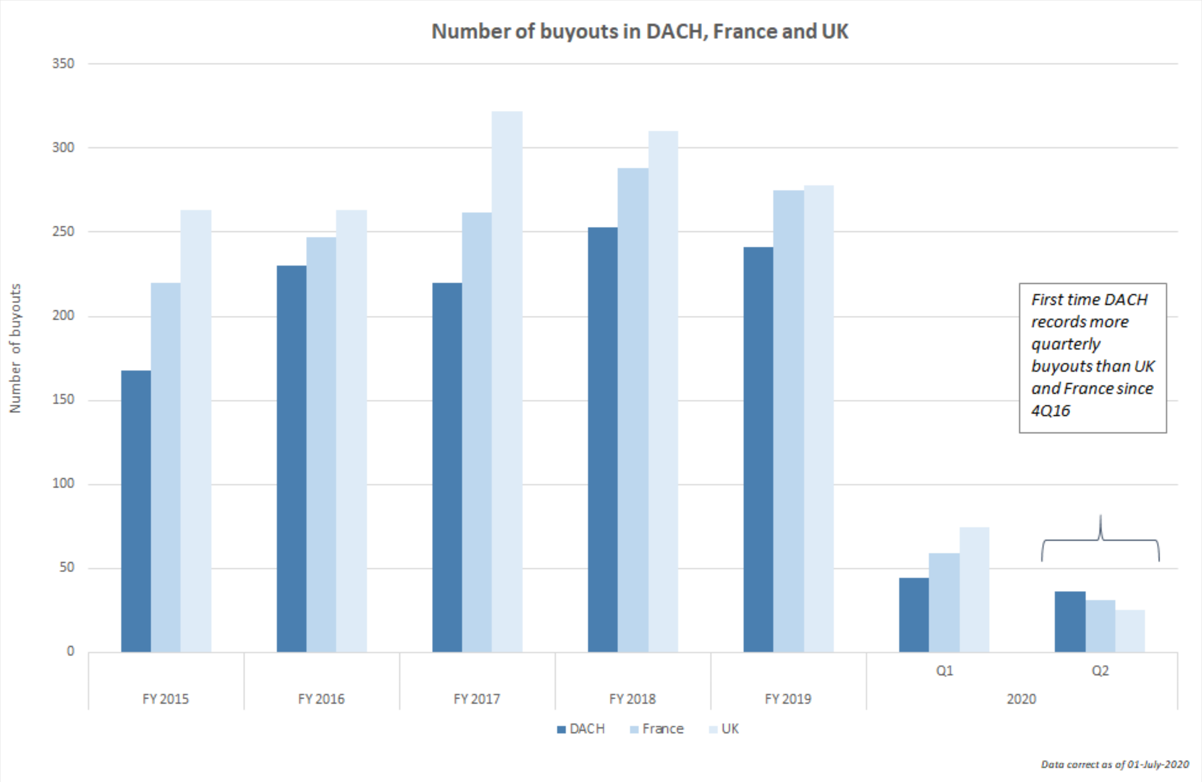


Buyouts boost

Second quarter numbers, which saw value drop to a historic low as lockdowns were enforced, were ultimately made more palatable by deal activity generated by DACH mid-cap buyout groups, which have proven to be more resilient than European counterparts during this crisis.

The DACH region recorded a total of 36 sponsor-led acquisitions, taking an 18.1% share of European buyout activity in 2Q20, putting it at the top of the charts ahead of France with 31 buyouts and the UK with 25, according to *Mergermarket* data.

"With private equity investors creating special COVID-19 investment structures and other capital solutions at hand we can expect to see a still active buy-side and buy-and-build market," said Dirk Middelhoff, Partner at **Clairfield International**.



As Europe continues to emerge gradually from months of lockdown, practitioners are cautiously optimistic that deal activity in the DACH region will slowly gather steam in 2H. "It all depends on what the COVID situation will be, but I would expect fairly busy activity for the second half of the year," said Christian Schulz, Head of DACH M&A at **EY**.

German industrial production plunged by a record 18 per cent month on month in April as the coronavirus lockdown caused major disruption to factories across most manufacturing sectors of Europe's biggest economy.

The country's automotive industry – a crucial barometer for its economic performance – saw passenger car production plummet 97% on year in April, according to the industry lobby VDA. Even the more buoyant technology sector has seen upheaval recently following the collapse of payments company **Wirecard** [ETR:WDI] over its accounting scandal.

However, there are signs that Germany could be soon turning the corner, with retail sales showing a sharp 13.9% rebound in May as restrictions to ward off the pandemic were lifted.

"If things continue on this track of reopening, I expect a lot of deals that were put on hold will be live again," Schulz said.

Among the processes that were paused in the first half of this year are **Ardian**'s sale of audio equipment maker **d&b audiotechnik**; **Water Street**

Healthcare Partners' sale of diagnostics firm **Orgentec**; and **Armira**'s sale of bulletproof textiles maker **Mehler**.

Reboot, restart

German transactions continued to account for the lion's share of the region after recording its second-highest quarterly deal value in 1Q20 at EUR 41.1bn, *Mergermarket* data shows. Austria and Switzerland also made a significant contribution to the region's performance with some multi-billion transactions.

In Austria, chemicals company **Borealis** was sold to **OMV AG** for USD 4.68bn in March, and animal nutrition business **ERBER** was acquired by **Royal DSM NV** [AMS:DSM] for EUR 980m – the second largest inbound transaction announced in Q2. Switzerland had three deals among the DACH's top 10, including the sale of **Veeam Software** to **Insight Partners** and of **Global Blue**, a tax refund company acquired by **Far Point Acquisition Corporation**.

DACH's pharma, medical and biotechnology sector sustained its appeal to investors during the lockdown months. The space saw 26 deals in Q2, accounting for 14.4% of the region's M&A activity in the period – the highest share per quarter on record.

Pfizer's [NYSE:PFE] USD 185m investment in Germany's **BioNtech** [NASDAQ:BNTX] – the start of a potential USD 748m participation in the firm – as part of a collaboration to develop a COVID-19 vaccine was an example of activity in the sector, which is likely to see more deals coming months.

For the rest of 2020, sectors such as tech and telecoms are likely to drive M&A activity in the region, dealmakers said, citing the pandemic's relatively low impact on the space and trends pre-dating COVID-19 such as digitalisation.

Technology deals accounted for 21.4% of activity by deal count in 1H20, the highest share on a half-year basis on *Mergermarket* record. These included **Align Technology**'s [NASDAQ:ALGN] EUR 376m acquisition of dental software company **Exocad** ; **Schneider Electric**'s [EPA:SU] takeover of ERP developer **RIB Software** [ETR:RIB]; and **Atlas Copco**'s [STO:ATCO-A] acquisition of machine vision manufacturer **ISRA VISION** [ETR:ISR].

"In these sectors not heavily affected by the current situation, there's not really been a change in terms of processes or length of processes, so I think we will see some nice deals here," said Henning Graw, member of the executive board at **IMAP** in Germany.

Telecom infrastructure assets such as mobile towers or passive infrastructure could also see increased interest, said Andreas Stöcklin, Head of Corporate Finance and Germany leader at **Duff & Phelps**.

"They are very long-term investments with predictable cashflow profiles, and offering significant upside potential from increased asset utilization," he said, adding that many infrastructure and PE funds are keen to acquire assets in this domain.

Deals on par with **Telefonica Deutschland**'s sale of more than 10,000 mobile sites to **Telxius Telecom** for EUR 1.5bn and an EBITDA multiple of 23x could take place in 2H, he added.

Another source of deals in 2H20 is expected to come from sectors adversely affected by the crisis, in the form of distressed situations. Already in the first half of the year, household names such as retailer **Galerie Karstadt-Kaufhof**, restaurant chain **Vapiano** and leather goods maker **Picard** were involved in rescue deals at least in part as a consequence of the pandemic.

"We see a vast range of companies coming to market in industries such as retail or automotive, which have been kept alive during the recent economic heydays despite structural challenges," Simon Pfennigsdorf, Partner at **Orlando Management**, said. This first wave of economic headwinds has already caused a collapse of companies in these fields, and they will require fresh equity to restructure business models, he added.

Foreign appeal

Throughout the pandemic, companies in the DACH region have remained attractive targets for foreign investors, accounting for 20% of inbound activity in Europe by volume in 1H20, the highest share compared to all annual figures since 2009.

Japanese buyers in particular accounted for 12 deals in 1H, on par with 13 deals in 2H19 despite the COVID-19 slowdown, *Mergermarket* data shows. Notable transactions here include **Hitachi Automotive Systems** acquisition of **seneos**, an automotive device software developer, as well as **Nihon Spindle Manufacturing**'s purchase of machine maker **Leifeld Metal Spinning**.

China on the other hand has faced a more challenging regulatory environment due to Germany's tightening of foreign direct investment rules. On June 18, the German Federal Parliament passed the second of three planned reform steps of German FDI rules, in particular for M&A transactions in critical infrastructure.

The first half of this year saw six Chinese buyers targeting DACH companies, a much lower number compared to its peak in 2016, when 22 and 20 deals were announced in the first and second half of the year.

In an example of how the DACH region, like other countries, could be stepping up protectionism measures further, the German government invested EUR

300m in **CureVac** in June, taking a 23% stake in the business after it reportedly attracted interest from the Trump administration.

Corporates cash in

Still, cash-rich corporates will likely continue to pursue strategies of inorganic growth in 2H20. "For the rest of the year, we are expecting a comeback of smaller deals from larger sellers, fire sales which have to happen, deals involving targets not affected by the pandemic and public takeovers involving undervalued companies," according to Cai Berg, Senior Managing Director at **ParkView Partners**.

Deals that could fill the 2H pipeline include **Deutsche Lufthansa**'s [ETR:LHA] considerations to divest of its **Airplus International** corporate payments business; **Warburg Pincus**'s planned sale of Swiss banking software company **Avaloq**, and **Lonza**'s [SWX:LON] divestment of its EUR 3bn **Specialty Ingredients** (LSI) unit.

Given the lingering uncertainty from COVID-19, valuations are likely to remain a sticking point for deals as buyers and sellers come to grips with the impacts of the pandemic on assets, advisers said. Due diligence criteria to value companies will become more stringent, requiring targets to provide evidence that they can survive another crisis and prepare for supply-chain disruptions, as discussed by *Mergermarket* earlier this year.

As a result, there are likely to be more minority deals, where private equity firms offer a capital increase and inject fresh money into a business, because the seller will not accept valuing the company based on 2020 figures, IMAP's Graw said.

Dealmakers could as a result turn to instruments such as earn-outs and material adverse change (MAC) clauses or all-equity transactions to bridge the gap between sell-side and buy-side expectations.

As advisers and companies adjust to the "new normal" of the post-COVID-19 world, a bit of creativity and flexibility could go a long way in closing deals.

by Patrick Costello and Emma-Victoria Farr, with analytics by Olivier Gilkinet