German Trendspotter: Cross-border and carve-out deals to weather political and economic uncertainty in 2017 - Analysis

Proprietary Intelligence

- Bayer/Monsanto, Syngenta/ChemChina boost overall deal value
- Increasing mid-cap succession issues to lead to more M&A
- Corporate carve-outs likely to dominate IPO market in near term

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German M&A has borne the brunt of uncertainty throughout Europe this year but the country's own upcoming general elections in 2017 will mark a real test of resilience.

This year so far Germany has recorded 787 deals at a total value of EUR 66.8bn, according to *Mergermarket* data. This represents a 19% increase in value and 13 more deals than the same period last year.

"Given the relatively low growth environment, companies continue to be acquisitive as a means for taking out costs, achieving growth, or both," said Stefan Mueller, Head of Investment Banking for Germany, Austria and Switzerland at **Moelis & Company**. "As we look to the first six months of 2017, innovation and transformational M&A will become increasingly important drivers for large businesses," he added.

The cross-border theme will also keep deals ticking over, Mueller said. During the course of the last year, German companies were particularly active outside Germany, including **Bayer** [ETR:BAYN] and **Monsanto** [NYSE:MON], **Hapag-Lloyd** [ETR:HLAG] and **United Arab Shipping Company** (UASC), **Henkel** [ETR:HEN3] and **Sun Products**, **Siemens** [ETR:SIE] and **Gamesa** [BME:GAM], and **Deutsche Boerse** [ETR:DB1] and **London Stock Exchange** [LON:LSE].

Cross-border M&A will also be boosted by private equity with capital to spend. "While private equity funds have been sitting on significant dry powder, 2016 performance was fairly weak compared to 2015," Mueller said.

So far in 2016 there have been 120 exit deals valued at EUR 14.6bn, which is 19.4% down by value compared to last year but with eight more deals. Of these deals, 83 were via trade sales valued at EUR 10bn, and 35 were through secondary buyouts valued at EUR 4.4bn, according to *Mergermarket* data.

"Funds are strongly capitalized and debt markets very supportive. However, corporate players can be very competitive bidders in synergetic transactions," said Kai Tschoeke, Managing Director at **Rothschild Global Advisory**.

A large flow of mega deals this year will lead to resulting M&A next year as large corporates embark on spin-outs and divestitures as a result of these combinations. And "as valuations continue to edge higher, companies will seek to take advantage by selling non-core and legacy assets," Mueller said.

Transaction prices remain very high as good targets are few and sought after, Felix Hoch, Partner at German advisory firm **CH Reynolds Corporate Finance**. As such, "the only significant hindrances to the current pace of deal-making are increasing valuations and the availability of targets," Mueller said.

Old economy rises to Industry 4.0

German M&A has always been driven by the Industrials and Chemicals sectors which will likely continue in 2017 as German corporates take on the Industry 4.0 challenge, a government-backed initiative to unite technology with industry.

"We expect to see continuing strong activity by German "old economy" corporates in the field of Industry 4.0 in the context of a fast-changing environment and competition," Mueller said.

“Focus will be on parts of the automotive sector, healthcare and chemicals, and also some portfolio alignments in utilities following the reorganisation of the core players,” Tschoeke said.

After a relatively weak German IPO year in 2016, with clean energy firm **innogy** [ETR:IGY] being by far the landmark transaction of the year, the pipeline looks optimistic, coming from a mixture of PE exits, corporate restructurings and private companies, Tschoeke said.

“There is pressure from shareholders driving disposals, spin-offs and carve-outs in listed companies,” said Michael Maag, Head of Swiss Investment Banking Coverage at **Morgan Stanley**.

The likely uptick in IPOs next year will be driven by German tech companies listing in the US, Mueller said.

Chinese not waning

China’s ever-increasing interest in German technology companies is also expected to continue in 2017. “Chinese investors have become increasingly sophisticated over the past years and have moved from targeting the hidden champions in the Mittelstand to large, listed German corporates,” Mueller said.

However, the pace of the deal activity has caused some skepticism among some German policymakers, so it remains to be seen how Germany will deal with Chinese investors in the future.

“While German angst towards Chinese investors may hinder deal activity, the interest in German brand-name companies will increase,” Mueller said.

Deals involving German targets often aim to gain technologies, Hoch said. German automotive targets are also highly sought after, he added.

“Whether the volume of FDIs from China will continue at the same level is more likely to depend on Chinese foreign exchange considerations than on any potential tightening of German M&A regulations,” Tschoeke said.

Swiss succession

A continuing theme in Switzerland and the DACH region is generational change at mid-cap companies driving M&A. Many companies are now being owned by the second generation, where families are becoming quite large and beginning to look at options.

For example **Looser Holding** [SWX:LOHN], a Swiss coatings firm, was owned by a spread out family with no obvious successor, and it decided to join together with **AFG** [SWX:ARBN], noted Martin Menzi, Managing Partner at **Alantra Switzerland**, at the *Mergermarket* Swiss M&A and Private Equity Forum.

"Swiss companies are looking to diversify their cost base outside of the CHF area which can also be a driver of M&A activity,” Maag said. Swiss statistics show deal count down by 12 year to date in comparison with the same period last year, yet deal value has soared 341% over the same time, according to *Mergermarket* data. This is largely due to **ChemChina**’s acquisition of **Syngenta**‘s [VTX:SYNN] in February.

Overall figures across the DACH (Germany, Austria, Switzerland) region year to date show an increase in deal value of 81.5% (EUR 132.4bn) with four fewer deals compared with the same time frame last year, according to *Mergermarket* data.

The Brexit, Trump effect

“Without question M&A generally benefit from the free flow of goods, people and capital, and both Brexit and the new US government could potentially point to the opposite direction,” Tschoeke said.

However, with regard to M&A, direct investment in target markets abroad can actually be a kind of insurance policy for current uncertainties, and thus support M&A levels rather than being a drag on activity, he said.

Brexit has created a lot of uncertainty in Europe and this climate is expected to continue in 2017, Felix Schwarzwaelder, Associate at German M&A boutique **Transfer Partners** said.

Upcoming elections in the Netherlands in March, France in April, and Germany in September will contribute to the current uncertainty and lack of visibility for the future, Hoch said. Angela Merkel's Christian Democratic Union (CDU) has dropped in opinion polls following her open door refugee policy. The Green Party and Alternative for Germany (AFD) have gained in popularity.
A slowdown in the M&A market in 2017 is more likely in the second part of the year, as a result of the high levels of uncertainty, Hoch and Schwarzwaelder said.
by Emma-Victoria Farr, Patrick Winters and Laura Larghi, with analytics by Katharine Dennys and Silvia Paparello
Target: Monsanto Company
Financial advisor: Morgan Stanley, Ducera Partners
Lawyer: Wachtell, Lipton, Rosen & Katz
Bidder: Bayer AG
Debt Provider: Goldman Sachs, Credit Suisse Group AG, HSBC Holdings Plc [滙豐控股有限公司] , JPMorgan Chase & Co., Bank of America Merrill Lynch
Financial advisor: Credit Suisse Group AG, Rothschild, Bank of America Merrill Lynch
Lawyer: Sullivan & Cromwell LLP
Vendor: Monsanto Company, Bayer AG
Target: United Arab Shipping Company (S.A.G.) [الملاحة العربية المتحدة]
Bidder: Hapag-Lloyd AG
Target: The Sun Products Corporation
Financial advisor: Morgan Stanley
Lawyer: Kirkland & Ellis LLP
Bidder: Henkel AG & Co KGaA, Henkel Consumer Adhesives, Inc
Debt Provider: Deutsche Bank AG, JPMorgan, BNP Paribas SA
Financial advisor: Credit Suisse, Perella Weinberg Partners LP
Lawyer: Cleary Gottlieb Steen & Hamilton LLP
Vendor: Vestar Capital Partners, Inc.
Target: Gamesa Corporacion Tecnologica SA [Gamesa Corporación Tecnológica SA]
Financial advisor: Credit Suisse, Morgan Stanley
Bidder: Siemens AG
Financial advisor: Goldman Sachs
Vendor: Iberdrola SA
Other: AREVA SA
Target: London Stock Exchange (LSE) Plc
Financial advisor: Goldman Sachs, JPMorgan, Societe Generale [Société Générale S.A.] , UBS Investment Bank, RBC Capital Markets Inc, Barclays, Robey Warshaw LLP
Bidder: Deutsche Boerse AG [Deutsche Börse AG]
Financial advisor: Deutsche Bank AG, HSBC, Bank of America Merrill Lynch, Perella Weinberg Partners LP, HSBC Investment Bank Holdings Plc
Other: Eurex Frankfurt AG, Eurex Clearing, [company record pending]
Target: innogy SE
Book-runner: UBS AG, Credit Suisse Group AG, BNP Paribas SA, Bank of America Merrill Lynch
Co-lead manager: Banco Santander, S.A., RBC Capital Markets Inc, Berenberg Bank
Global Co-ordinator: Goldman Sachs, Deutsche Bank AG
Vendor: RWE AG
Target: Looser Holding AG
Financial advisor: ALANTRA
Lawyer: Homburger, Lenz & Staehelin
Bidder: AFG Arbonia-Forster Holding AG

Financial advisor: UBS Investment Bank
Lawyer: Baker & McKenzie
Target: Syngenta AG
Financial advisor: Goldman Sachs, JPMorgan, UBS Investment Bank, Dyalco
Lawyer: Davis Polk & Wardwell LLP, Baer & Karrer
Bidder: China National Chemical Corporation [中国化工集团公司]
Agent: Credit Suisse
Financial advisor: HSBC, China CITIC Bank Corporation Ltd. [中信银行股份有限公司]
Lawyer: Simpson Thacher & Bartlett LLP, Homburger
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