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DACH Trendspotter: Financial investors to sustain deal flow as suitable targets dwindle

- Linde/Praxair, Techem to boost deal pipeline
- Brexit fosters more uncertainty than international politics
- Alternative deal structures used to counter high prices

In Germany, chaos is relative. While the political scene may be murky and unclear, economic news is positive and dealmakers remain upbeat heading into 2018.

Such sentiment does not come without good reason, with DACH deal value reaching its second highest level on *Mergermarket* record at EUR 153.4bn from 1,082 deals, and some deals set to close in the weeks before Christmas, 'tis certainly the season to be jolly.

Characteristically, Germany leads the way, accounting for EUR 110.8bn of that figure from 821 deals. While the largest deals derive from the industrials, pharma and energy sectors, deal count shows an increasing level of activity among technology and business services, according to *Mergermarket* data.

And this is likely to drive optimism into next year.

"Deal activity will most likely increase in the first half of 2018. While broader European macroeconomic uncertainty will not be solved overnight," Dominik Stein, partner at **EQT** in Munich said. "With the abundance of dry powder in the market, investors are likely to become more active."

This looks set to be supported by private equity and corporates looking to take advantage of high multiples and strongly consider exits or disposing non-core assets, Stein said.

Some large-scale deals seem likely to involve both sets of buyer groups, such as **Messer Group**, a Germany-based supplier of industrial gases. It intends to buy some of the assets that **Linde** [ETR:LIN] and **Praxair** [NYSE:PX] need to offload to ease competition concerns over their merger. For this, it is likely to team up with **CVC**, adding further firepower when submitting a bid.

Another hotly anticipated sale is that of German metering business **Techem -** a EUR 1bn deal that will significantly boost German M&A values next year. Canadian funds **OTPP** and **CDPQ**, together with Singaporean investor GIC, are additionally joining forces to bid for the asset, as reported.

Macquarie is aiming to sell at a 14x-plus EBITDA multiple on the back of the recent sale of German submetering company **ista**. Chinese infrastructure investor **CKI** acquired ista from CVC in July for around EUR 4.5bn, beating the nearest bidder by a rumoured EUR 1bn.

Alternative deal structures

Ongoing differences in price expectations has also encouraged a more open-minded approach to deal structures, with the market becoming more flexible in terms of majority and minority stakes, and also in how long private equity houses hold onto portfolio firms.

"For private equity in particular, it's not so much a case of where to invest, but how to invest. More generally, it is likely that investment methods will continue to stray from the buyout norm, whether that be through public-to-private takeovers or minority investments," Stein said.

Transaction prices will be high and stable, Yuan Hartono, project manager at **Transfer Partners** said. Sectors such as advanced technology services have seen EBITDA multiples beyond common sense, driven by an excess of dry powder in a sellers' market.

Felix Hoch, partner at **CH Reynolds Corporate Finance**, expects the number of M&A deals to remain stable in 1H18, and while transaction prices are high these too will even out, he said.

Too much cash, too few targets

Financial players have plenty of cash but there is a dearth of suitable targets, Hartono said.

German companies still have an abundance of capital and no better alternative to invest than M&A, Hoch said. The German Mittelstand is becoming more open to expansion and usually buy to gain a geographical footprint, he added.

For CH Reynolds, there has been a marked increase in buyside mandates. Increasingly more family offices are investing directly into businesses too, Hoch said.

While private equity has the dry powder, strategic investors tend to pay a higher price if they decide to invest, Christian von Sydow, partner at **McDermott Will & Emery**, said.

Macroeconomic challenges: Brexit, Trump or German politics?

German investors will postpone short-term acquisitions due to uncertainty surrounding Brexit, Hartono said. President Donald Trump's mercurial temperament and an uneasy German political situation are unlikely to impact M&A in comparison, he said.

While the US administration is creating economic and political uncertainty, it is difficult to predict its impact on the M&A market, Hoch said.

For Germany, Brexit fosters more transactions, von Sydow said, acknowledging just how deeply Brexit is affecting M&A, Hoch added.

German players are no longer keen to acquire UK companies, as the uncertainty of Brexit's outcome remains too high, he said. A sentiment echoed by Philip Meichssner, head of M&A at **Osborne Clarke.**

On the other hand, the number of UK buyers looking for targets in Germany has significantly increased. Gaining a footprint in the EU is now important, Hoch said. With the potential of leaving the single market looming, companies have come to the realisation that the UK will not provide a suitable foothold from which to conduct business in the Eurozone.

There has been much speculation surrounding potential new elections in Germany in early 2018. However, another election would likely change little, reading the latest polls. Berlin-watchers expeca grand coalition between the Christian Democrats (CDU/CSU) and Social Democrats (SPD) is the most likely outcome from the current transition government.

A government will be formed, likely led by Angela Merkel, resulting in little significant impact on the M&A market from domestic politics, Hoch agreed.

Cross-border and hot sectors

While Chinese investment into Germany waned in 2017 due to capital restrictions, Japanese players are gaining ground in terms of cross-border investment from Asia.

"We see more volume and activity from Japanese corporates in Germany. They share similarities to Germany and are showing interest in relevant sectors such as industrials and technology," Jan Caspar Hoffmann, managing director and head of M&A in German-speaking Europe at **Moelis & Company,** said.

The US still feeds Germany with the most inbound investment as it is a stable EU member state, von Sydow said.

After the Linde/Praxair deal**, Johnson & Johnson's** [NYSE:JNJ] takeover of Swiss firm **Actelion Pharmaceuticals** was the second largest deal in the DACH region, at EUR 27.6bn, according to *Mergermarket.*

Business services deals in Germany increased 96.4% in value YTD 2017 in comparison with the same period the year before, according to *Mergermarket*. With cross-sector digitalisation, technology support services for companies are increasingly in demand.

In the automotive sector, companies are looking for innovative technologies in fields such as batteries and battery management systems, Hoch said. Similarly, mobility sectors such as transportation will attract strategic and financial players, Meichssner noted.

Activities in the insurance sector are set to continue in 2018, Michael Kluettgens, head of Insurance Consulting and Technology at **Willis Towers Watson** in Germany, told this news service.

German life insurance companies are facing more challenges compared to companies abroad, due to very high guarantees and the long duration of the contracts. Therefore run-off platforms, which compete with traditional insurers, will consider the German market attractive for acquisitions driven by a greater need for efficiency, Kluettgens said.

Aside from "insurtech", Philip Meichssner expects the life sciences sector will see strategic players acquiring technology firms to transform into digital health companies.

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