Industrial automation

German Trendspotter: Mid-cap mandates to dominate uncertain deal climate - Analysis
Proprietary Intelligence

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- Mittelstand industrials pipeline to boost deal activity
- IPO market stuttering but not stalling; niche sectors more successful
- Brexit impact leaves uncertainty hanging over markets

After a strong first half, Germany will rely on its sturdy backbone of mid-cap family owned firms turning to M&A as well as accelerating outbound activity in the second part of the year to ward off market uncertainty in Europe, according to dealmakers.

The first half of 2016 saw the highest deal value since 1H14, at EUR 27.1bn, according to *Mergermarket*'s trend report found here. This was a 6.1% increase on 1H15, despite the number of deals decreasing by 24 to 386. This is down to a handful of large deals, including Chinese conglomerate **Midea**'s [SHE:000333] EUR 3.8bn offer for German robotics specialist **KUKA** [ETR:KU2], private equity house **KKR**'s EUR 1.6bn sale of family-owned kitchenware firm **Wuerttembergische Metallwarenfabrik** (WMF) to **Groupe SEB** [EPA:SK], and **Bilfinger**'s [ETR:GBF] divestment of its Building and Facility division to **EQT** for EUR 1.4bn.

Main body : As shown by the ongoing macro-economic and regulatory challenges faced by the proposed merger between **London Stock Exchange** (LSE) [LON:LSE] and **Deutsche Boerse** [ETR:DB1], the uncertainty brought about by Brexit will influence the European economic and financial scene in the second half of 2016, Felix Hoch, partner at German M&A firm C.H. Reynolds Corporate Finance said. Additional uncertainty will be triggered by the US election in November, he added.

"Deals involving UK companies are being decelerated, waiting for clear indications from the UK and European authorities on next steps," Hoch said. New deals will include more conditions and clauses to cover the unstable situation, he added.

Mittelstand and cross-border

M&A deals among medium sized German players are expected to continue in the second part of 2016, Hoch said. Industrials and chemicals sectors are proving the most popular, increasing in total to EUR 15.7bn, an increase of 257% on 1H15, according to *Mergermarket* data.

Hoch suggested that German medium sized companies, known as Mittelstand, are becoming more active in the M&A market, pointing out that his company has received buy-side mandates from such firms. Deals involving German small and medium sized companies are expected to continue in the second part of the year, Myriam Schilling, partner at German law firm Oppenhoff & Partner agreed.

Successions issues will drive deals while cash rich German companies are also on the lookout for attractive candidates, Hoch said. German outbound M&A points to a promising second half of the year, totalling EUR 46bn in 1H16, a record-breaking increase on 1H15 (EUR 5.2bn) .

A lack of investment alternatives and strong deal appetite from family offices and financial investors will continue to have a positive impact on M&A and drive up prices, according to Hoch.

Chinese buyers are likely to continue pursuing their deals, as transaction prices are not their main concern, Hoch and Schilling said. Germany is the most popular Chinese investment destination this year by deal volume, with 17 acquisitions valued at EUR 7.7bn overtaking all annual deal values on record, according to *Mergermarket* data.

On the other hand, deals involving UK firms have been put on hold for the last two to three months, Schilling said. The uncertainty on the outcome of the referendum had already cooled down investors' appetite in advance, she explained.

Large cross-border deals such as LSE/Deutsche Boerse will become more challenging, Hoch said. Similarly, Schilling does not expect to see large cross border deals or IPOs in the second part of 2016 as the uncertainty surrounding the financial and economic situation remains too high.

However, in the IPO market the situation may change quickly as equity investors have a historically high cash position and may regain confidence in 2H16, especially for niche businesses and sectors that are not exposed to macro uncertainties, Oliver Diehl, Head of Equity Capital Markets at Berenberg said.

Risk aversion

A rush to close deals at late stage of negotiation in the short term is not excluded as companies aim to take advantage of current regulation, Schilling said. However, she added, German investors, traditionally risk averse, will probably stay away from any deal or investment involving UK counterparts.

Private equity firm **Cinven** has postponed plans to sell UK-based web hosting firm **Host Europe Group** (HEG) due to market uncertainty following the UK's vote to leave the European Union, *Mergermarket* reported. **Deutsche Telekom** [ETR:DTE] had been in talks with PE firms including **BC Partners**, **Warburg Pincus**, **Hellman & Friedman** and **Blackstone** about making a joint bid for HEG. **United Internet**

[ETR:UTDI] was also expected to make an offer, as reported.

Financial and insurance sectors are the first to be affected by Brexit, Schilling said. It could also present an opportunity for Frankfurt, the first candidate to take over business from London, she said.

There is still a small chance that the Article 50, the first stage of leaving the EU, will not be triggered, Schilling and Hoch said.

Following the initial shock investors and market players are looking at different scenarios to evaluate Brexit and its potential consequences, Timo Buehler, associate at law firm Herbert Smith Freehills in Frankfurt said. He has yet to see concrete reactions from his clients.

Should other European countries follow the UK's example, a significant economic downturn can be expected, he said. Notably heavily regulated sectors such as energy and finance may be affected, and differing national regulatory regimes may trigger divestitures and similar M&A activity, he commented.

The main question remains the speed of the Brexit, Buehler said, adding that uncertainty will probably slow down market activity.

Challenges will increase for the financial sector while Brexit could represent an opportunity for the real estate sector in Germany. It could increase its attractiveness for foreign investors, Buehler said.

by Emma-Victoria Farr in London and Laura Larghi in Munich, with analytics by Katharine Dennys

Target: KUKA AG
Bidder: Midea Group Co., Ltd. [美的集团股份有限公司]
Other: Siemens AG, ABB Ltd

Target: WMF Wuerttembergische Metallwarenfabrik AG [WMF Württembergische Metallwarenfabrik AG]
Bidder: Groupe SEB SA
Financial advisor: Credit Agricole [法国东方汇理银行]
Vendor: Kohlberg Kravis Roberts & Co. L.P.
Financial advisor: Deutsche Bank AG, Citi [花旗集團]

Target: Bilfinger SE (Building and Facility division)
Financial advisor: Deutsche Bank AG, Bank of America Merrill Lynch
Bidder: EQT Partners AB
Vendor: Bilfinger SE

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

	Target: HEG *Financial advisor:* Deutsche Bank AG **Bidder:** BC Partners Limited, Deutsche Telekom AG, Hellman & Friedman LLC, Blackstone Group LP, Permira Advisers LLP, Warburg Pincus LLC, United Internet AG, Strato AG **Vendor:** Cinven Partners LLP *Financial advisor:* Deutsche Bank AG
Source :	Proprietary Intelligence
Stake Value :	N/A
Grade :	Confirmed
Alert :	Germany
Intelligence ID :	2264362