Megatrends – drivers of the European M&A market

Andre Waßmann, Helbling Business Advisors, Dusseldorf

1. Global Trend Snapshot

For the third time in this still relatively young century, the M&A market has come under considerable pressure due to what is currently a multiple, interdependent crisis. After the bursting of the dotcom bubble in 2000, the market had barely recovered by 2007 and reached its old level (18,441 deals, EUR 1,760 bn) when it plunged again in 2008 and 2009 due to the subprime crisis and the collapse of Lehman Brothers. Across Europe, the deal volume in the years 2009 to 2013 ranged between EUR 520 bn and EUR 724 bn, with lows in 2009 and 2013. The number of deals during this period remained relatively high but reached a temporary low in 2013 with around 14,470 transactions. This was followed by another bull market, driven mainly by the massive supply of liquidity to the market by the European Central Bank and the development of new business models. Between 2014 and 2018, the M&A market reached a new plateau, with 17,850 transactions in 2018 at a total value of approximately EUR 1,100 bn.

Since 2019, M&A activity has been declining again, driven by unprecedented economic uncertainties. In the crises at the beginning of the millennium, singular crises were responsible for market collapses. Now, however, we are confronted with the consequences of various structurally relevant social and economic developments. The symptoms of these developments have so far included changing roles of global political power centers, in which Europe is still trying to find its role, intra-European divisions, such as the Brexit, the refugee crisis, and currently the COVID 19 pandemic.

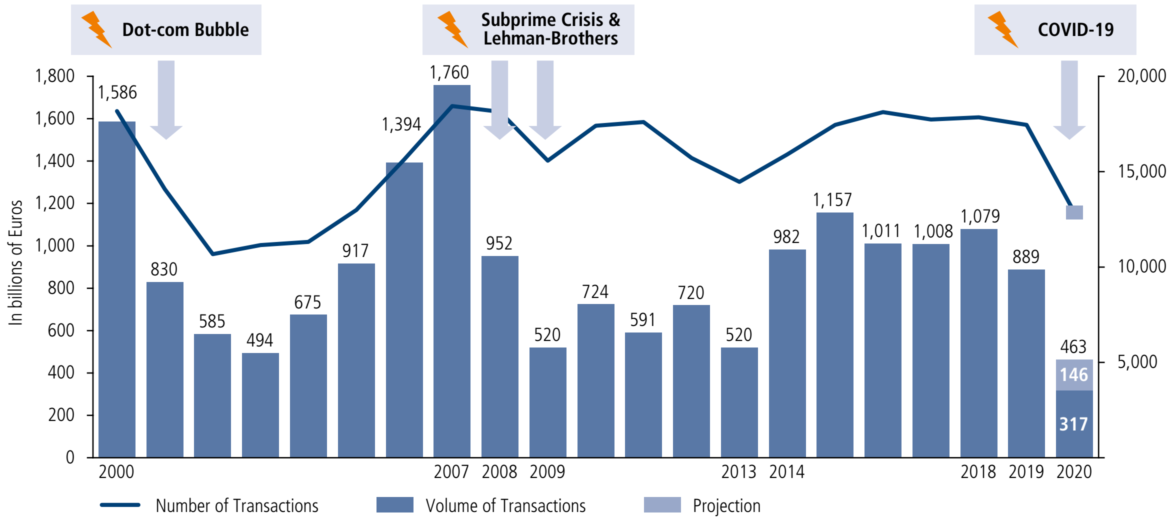
In 2019 the European M&A business volume collapsed to around EUR 890 bn (- 18%). 9/2020 it was only around EUR 320 bn, based mainly on the result in Q2 2020, the weakest quarter since Q3 2009. Projected for the full year 2020 this would be around EUR 460 bn, only slightly more than half of the previous year. Interestingly, activity will have decreased much less dramatically between 2019 and the end of 2020 (projected). Even in the European SME sector – a generally stable segment –, transaction volumes have declined significantly after a strong first quarter of 2020 (+15% compared to 2019 (source: argos.wityu)). These figures illustrate that there is great potential for catching up in the remaining months of the year, assuming a corresponding economic recovery. Depending on the development of the pandemic in the respective European countries, the magnitude of this potential varies. The short-term development is comparable to the crisis in 2008/9 (deal count minus 22%, deal volume minus 46%) and 2000/1 (deal count minus 22%, deal volume minus 48%). Nevertheless, a quicker recovery compared to former crises is a realistic scenario given the significant improvement of the general business climate since the COVID 19 measures were implemented (European Economic Climate Indicator (ESI) with an increase of 36% to 86.9 in Aug'20 compared to Apr'20 with 63.8).

In Germany, on the other hand, despite a pandemic-related decline, the situation is relatively stable compared to the rest of Europe. In the first half of 2020, PE transactions fell by "only" 17% year-on-year, and the number of strategic transactions even fell by "only" 11% compared to the previous-year period. In terms of deal volume, there is a diametrically opposed development: In Europe, the number of mega deals fell from 37 to 19 from Q1 to Q2 2020 (source: Mergermarket). In Germany, by contrast, the deal volume in total has hardly changed between H1 2020 and H2 2019 due to the concentration on larger transactions in a lower number of transactions.

However, investors have become much more cautious, have stabilized their portfolio operationally and financially in Q2 2020 and postponed planned exits for the time being. Nevertheless, transactions that were already launched before the pandemic are generally still taking place and being closed. The terms and conditions remain roughly as negotiated before the crisis, but transaction partners mitigate potential risks contractually by implementing legal security mechanisms increasingly, as the desire for greater transaction security has raised as expected. Other processes have been postponed considering the sellers' own financial resources and the expected discounts on the purchase price. On the other hand, we are observing increased interest on the buy side respectively on investors' side who are keen to take advantage of the opportunity.

Fig. 1 • Europa M&A-Market Development

Source: IMAA-Institute; Helbling Research



Quo vadis 2020?

Although the economic development is estimated positively by leading economic institutes and also by the BMWI, it will be difficult to return to pre-crisis levels in the short term. Now, what does this mean for the M&A market in Europe and Germany in 2020? In our opinion, two major developments are predominant:

1) There will be a significant increase in distressed M&A transactions from Q3 2020 onwards in those industries that are suffering both from certain market developments, such as drop of mobility and tourism, and from financial collapses caused by the corona crisis. This is partly due to an increased net debt/EBITDA ratio (net debt/EBITDA 6.3 times as high in Q2/20 vs. Q2/19 for the top 20 MDAX companies by revenue, excluding insurance companies and banks) but also to a rapidly declining liquidity, which cannot be bridged by every company even despite the current government corona aid. According to the KfW, 45% of the liquidity reserves of 3,000 surveyed SMEs have already been depleted. The demand for so-called pre-insolvency M&A transactions, but also for M&A processes in the context of insolvency, is already rising. These transactions are likely to increase even further once the COVID related obligation to file for insolvency expires at the end of September 2020.

2) Growth M&A, i.e. M&A transactions that are intended as financial investments or for strategic growth, continue to have enormous relevance. However, for them to be successful despite the current crisis situation and to be meaningful and valuable in the long term, they must be oriented along essential criteria. Investors and buyers should increasingly focus on developments that will shape business in the long-term, i.e. the corresponding mega-trends. They are characterized by:
   a. a half-life of at least 25-30 years
   b. a change in every area of a company's life (including macro-environment and business areas)
   c. a global orientation

The Zukunftsinstitut has defined 12 megatrends, some of which interact with each other but are also interdependent. In our opinion, the following five megatrends will attract the largest share of future capital and largely penetrate the other megatrends:

1) Connectivity (most powerful megatrend, principle of networks and technology dominates social change)

2) Health (synonym for a good life, central goal of life deeply anchored in consciousness)

3) Security (individual perception of increasing crisis and complexity drive higher demand for security)

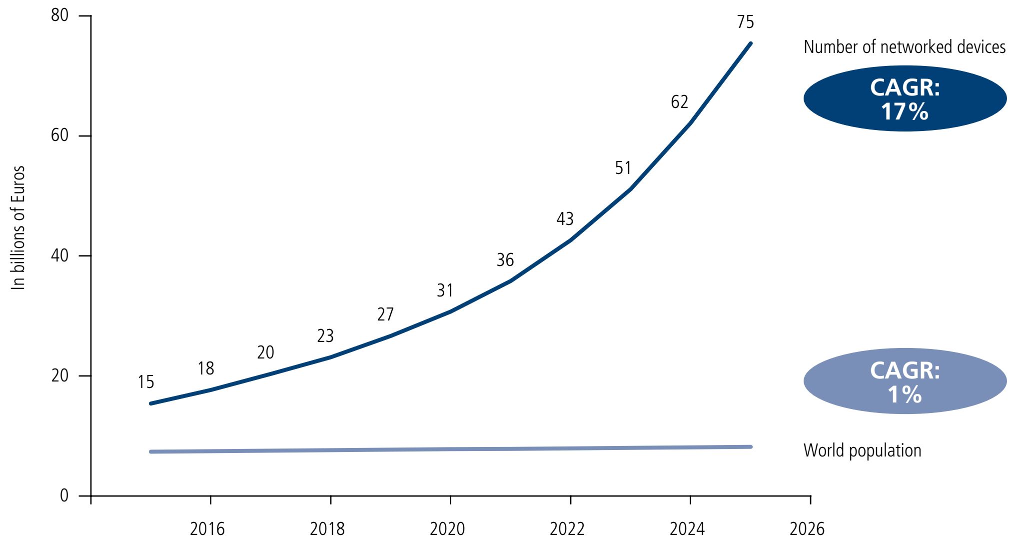
4) New-ecology (change process towards a resource-efficient, sustainable economy)

5) Mobility (increasing variety of forms of mobility, manifold and differing needs for (technology based) mobility, combination of various megatrends)

These five trends are reinforced by the advancing digital transformation. M&A deals in the tech sector, for example, have grown by 31% per year from 2013 to 2018, more than any other segment. They also stand out because no significant decline in M&A business could be measured despite the Corona crisis.

Fig. 2 • Global IoT Development vs Population

Source: Statista (2019); OECD (2020); Helbling Research



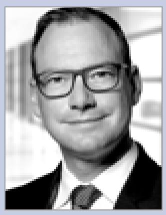
In other sectors, however, major targets were up for sale that no longer fitted into the core portfolio or reported heavy losses (e.g. Bombardier Transportation or the consolidation of Hapag-Lloyd Cruises and TUI Cruises). Or they were bought due to digital and/or ecological future prospects (innogy).

By early 2020, the Financial Services (21%), Industrials & Chemicals (20%) and Technology (10%) sectors accounted for around half of the total M&A volume across Europe. It is important to understand that the huge volumes in Financial Services and Industrials were mainly driven by two mega-deals. Furthermore, the transaction in Financial Services was based on the consolidation within the market of insurance services and brokerage. Thus, the dominance of these two segments was based on volume per deal and not on outstanding market development.

Even more interesting are the numerically dominating deals with business models derived from the megatrends: technologies, pharmaceuticals, medicine & biotech, telecommunications, computer services and energy. These already accounted for 33-40% of the transaction volume in Europe in H1 2020. In DACH these segments even accounted for approx. 52-60% (source: Mergermarket, Helbling Research).

A few key technology markets are examplary: the financing of FinTech models in Europe has decreased by 31% in volume in the first half of 2020 in line with other markets, but the number has increased. The M&A market for Healthcare recorded a record half-year. Transactions in the amount of EUR 113.6 bn were executed +44.6% compared to the same period of the previous year (source: Pitchbook). Investments in Artificial Intelligence grew by 49% between 2013 and 2019 (CAGR). M&A activity in IT services and cybersecurity grew by 23% between 2009 and 2018 (CAGR). The number of networked devices (in 2019 at 26.7 bn worldwide) is estimated at 75.4 bn for 2025 (Figure 2).

Digital transformation will continue to expand its role as a key driver of these five megatrends. AI, cloud computing, software-as-a-service models, big-data technologies, Internet-of-Things (IoT) and, in the future, quantum computers will offer novel, value-creating business models. They also help to solve socio-political and economic challenges and are an essential part of the political agenda. Business models that are not in line with the major megatrends will be consolidated or, even worse, become obsolete.



Andre Waßmann, Member of the Executive Board, Head of M&A, Helbling Business Advisors, has almost twenty years of experience as a strategy, M&A and corporate finance expert and as a strategy consultant for clients in the financial services and capital markets sectors. He has held various management positions at Accenture, Commerzbank and KGAL. Before joining Helbling Business Advisors and CFI Group, Andre was Partner at Clairfield International with a focus on the transaction market of startups, corporates and VCs in the fintech sector and other digital business models. He covers further technology-based innovation areas such as mobility and energy. At the investment management house KGAL, he was responsible for the development of innovative business areas, the M&A and venture capital investments and he implemented a digital investment platform. Besides this, he supports academia in the development of blockchain technology. His experience and network ranges from corporates and midcap companies to private equity, venture capital, and entrepreneurs. Andre graduated from business studies at Oxford University and in Ravensburg. He holds an MBA from Saïd Business School.