

## REGIONAL REPORT GERMANY

**Berthold Fuerst**

"In line with global M&A markets, Germany had an extraordinary year in 2007, with volumes up 30% compared with the previous year, primarily driven by corporates focusing on consolidation, cross-border acquisitions and corporate restructuring, as well as active financial sponsors during the first half of the year. The impact of the credit crisis led to a slowdown in activity in the second half, mainly due to there being fewer sponsor transactions.

This year is, at least for the first few months, likely to see a continuation of the second half of last year. On the one hand, continued closure of credit markets will limit sponsor activity to 'club deals', with significantly lower levels of debt financing. On the other hand, continued healthy conditions in the corporate sector, combined with less competition from private equity, translating into lower transaction valuation levels, will continue to drive M&A momentum.

German companies are prepared to support their organic growth through M&A and we would expect them to continue to leverage their financial strength to seize attractive opportunities outside their home turf. German

corporates in general are currently closely monitoring emerging markets in Eastern Europe and Asia, but also Europe and the US, to identify the right target. The relative strength of the euro is the supporting factor in this search for external growth.

These themes apply to all sectors of the economy. At the same time, we also expect inbound M&A activity to be supported by investors from the Middle East, Russia and emerging markets. Hence, we expect 2008 to be another good year for German M&A, although volumes may fall short of the record levels of 2007."

**Berthold Fuerst, head of German M&A, Deutsche Bank, Frankfurt**

**Richard Miller**

The current strength of Germany's economy means that its engineering and industrial businesses are generally performing well and make attractive targets for strategic and financial investors alike. This will continue to be the case in 2008. Also likely to be attractive to private equity investors will be businesses in the healthcare and business services sectors.

"Traditional' private equity funds are likely to see increasing competition for deals from sovereign wealth funds, specialist infrastructure investors and providers of integrated financing structures. If the current stock market woes continue, then investors will also be looking more closely this year at public-to-private opportunities across Europe."

**Richard Burton, partner, Transaction Services; and Richard Miller, director, Private Equity M&A, PricewaterhouseCoopers Frankfurt**

"In 2007, Germany saw only slightly increased M&A activity compared with 2006, thereby lagging somewhat behind other big European economies. Only a few transactions such as the €12bn acquisitions of SiemensVDO by Continental, Heidelberger Cements recent bid for British Hanson or Thomas Cook's merger with MyTravel are noteworthy. It is unlikely that German corporates will be more acquisitive in 2008 on a

large scale, although we might notice some increased transaction activity in the strongly growing Asian markets.

Activity was much stronger in the mid-market, where the market showed some healthy activity despite the sub-prime crisis, with both private equity investors and strategic investors in sectors such as media and pharma being particularly strong. In media, German companies were keen to catch up on on-line activities, which is illustrated by AxelSpringer's acquisition of the French on-line portal au feminine or Holtzbrinck's acquisition of the social website StudiVZ – a trend most likely to continue in 2008.

Noteworthy transactions in pharma were the acquisitions of Merck by US player Mylan and Betapharm by Indian company Dr Reddy's. The pharma industry continues to show worldwide consolidation and Germany, with its numerous mid-sized privately held pharma companies, will certainly contribute its share to global consolidation in 2008.

Dr Reddy's acquisition of Betapharm illustrates another trend well expected in 2008 – the acquisition of medium-sized manufacturing and

**Warren Scott****Richard Markus**

chemicals/pharma companies by Asian players. Last year saw a handful of these transactions and with Asian economies continuing to post strong growth rates there is no reason why interest from these players in a German presence and the technology sector should abate."

**Warren Scott and Richard Markus, co-heads for Germany, Jefferies, Frankfurt**

"The drop in German M&A activity for 2008, as a consequence of the sub-prime crisis, will be smaller than predicted. After a record M&A year in 2007, by both deal size and numbers, the mega-mergers will be rare, but mid-market transactions will increase.

Last year saw overall growth in deal volumes of more than 20%, whereas 2008 will return to 2006 levels. The German mid-cap M&A market will remain an attractive playing field, with reduced deal volumes, but an increased number of transactions. Investment banks will start focusing on smaller deal sizes.

With Germany being the lead market in Continental Europe, a similar development is expected for other European countries. Sound European corporate balance sheets will lead to strong investment activity from corporates in Germany as well as from the Nordic and Eastern European regions, where corporates have shown an increased appetite for cross-border investments into Germany. Further demand is expected for German targets from Asia and the Arab world.

This corporate M&A activity coincides with a significant shift from financial to strategic investors

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"I believe that what you saw towards the end of 2007 gives you a good flavour of what is to come in 2008. After the exuberance of the past few years, leverage is 'back to



normal'. So what I expect is smaller deals with less leverage, lower valuations, a run on the Mittelstand by the large players and even more focus on concrete management input.

Since last summer, the scope of financial engineering has continued to erode, so value creation through concrete operational input is rapidly becoming the key lever of success in our business.

For investment companies well positioned in the mid-market segment – like our firm – I don't see any reason to change the strategy. At GermanCapital we have operated for many years with flexible financing solutions that go well beyond mere equity and bank debt. So for us and for those players who can adapt to these circumstances, 2008 will be another great year.

Looking beyond one-year forecasts, I am a long-term 'bull' on Germany – particularly for our industry. Why? It's very simple. You have an extremely large pool of operationally sound Mittelstand companies in Germany. Since Basel II, the traditional regional bank-financing model for these companies has ceased to exist. This leaves the under-funded Mittelstand looking for alternative sources of capital.

On the operational side, these same companies are feeling the pinch of globalisation and need to invest in international roll-outs. Along with the capital requirements, this presents real managerial challenges to adapt, gain in efficiency and expand.

The adapting financing pattern of the Mittelstand and the operational challenges of globalisation are a reality in the German market that will be more visible in 2008 than in previous years. Those private equity players that are positioned to add value under this specific set of circumstances can look forward to some very good years."

**Dr Jürgen Diegruber, managing partner, GermanCapital, Munich**

after the credit crunch in the second half of 2007. Financial sponsors will take advantage of this shift through exits to strategic investors, which will often be able to pay a higher price than European financial sponsors, who had previously had access to aggressive debt leverage multiples in the buoyant buyout market. Sovereign funds are also likely to take a lead in larger buyouts.

This year is likely to see major consolidation and M&A activity in the German aerospace, financial services and media industries. Despite the credit crunch, private equity will continue to realise selected investments and exits will be dominated by sales to strategic investors. With these different developments, the outlook for 2008 remains positive."



**Andreas Pabsch, partner, MCF Corporate Finance, Hamburg**

"The record deal activity in Germany noted during the first six months of 2007 came to an abrupt end after the German M&A markets were hit by the global turbulence on the credit markets caused by the US sub-prime crisis and financing became increasingly difficult, especially for larger transactions.

There is considerable uncertainty about the overall German economic outlook in 2008, despite full company order books and falling unemployment rates. GDP has been revised slightly to lower levels, consumer confidence has come under pressure and private consumption has fallen accordingly.

The deal pipeline for early 2008 represents a different mix, as for larger transactions corporate investors are now driving the momentum. If markets stay robust and the German and Western economies avoid a severe recession, then M&A activity levels in 2008 can be expected to be only a little weaker than in 2007 but only in terms of deal volume rather than a halt in deal activity itself. Many professionals expect, however, a recessionary environment and the unresolved question is how big the effects will be.

The environment for the first half



**Uwe Kolb, partner, Bridgepoint Capital, Frankfurt**

of 2008 remains unstable with potential follow-on effects occurring if a more recessionary environment develops. Corporate restructuring, family succession and, to a lesser extent, divestiture of private equity portfolios, will drive deal flow. Larger deals will continue to be difficult to finance for a while; and mid-market deals will drive deal flow across all sectors."

**Uwe Kolb, partner, Bridgepoint Capital, Frankfurt**

"In 2008 we expect German M&A volume to continue the downward trend of Q4 2007, falling by around 20%–30% to match the levels of 2006, or even 2005. However, with exports likely to remain strong, the macroeconomic fundamentals will remain positive and high quality assets will still be in demand, causing any slowdown to be gradual.

Private equity M&A activity will be hardest hit, with the asset class struggling to achieve mega-deals, as financing banks take a more cautious stance on business models, market position, cashflow generation, interest cover ratios etc. Pricing and leverage are returning to more realistic levels and purchase price multiples could come down by 1.0–1.5x (EV/Ebitda).

As a consequence, private equity is believed to be less competitive in auction processes compared with last year. Instead, it will look for alternative types of transactions, focusing on more defensive business models and, increasingly, deploying equity rather than debt financing.

Private equity buyers may also turn their attention to private investments in public companies, or simply to smaller transactions. Early examples include the acquisitions of SAG by EQT or CasaReha by HG Capital, where Apax, Blackstone and BC Partners also showed interest, despite these being comparatively small deals for buyers of their size.

With corporate cash balances at their highest level since 1985, we expect strategic buyers to take over from private equity as the predominant driver of M&A activity in 2008.